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No. 10-__

IN THE

Supreme Court of the United States

COUNCIL TREE INVESTORS, INC., BETHEL NATIVE CORPORATION, AND THE MINORITY MEDIA AND TELECOMMUNICATIONS COUNCIL,

Petitioners,

v.

FEDERAL COMMUNICATIONS COMMISSION AND THE UNITED STATES OF AMERICA,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Section 706 of the Administrative Procedure Act, 5 U.S.C. § 706, provides that a reviewing court "*shall*— (1) compel agency action unlawfully withheld or unreasonably delayed; and (2) hold unlawful and set aside agency action . . . found to be . . . not in accordance with law . . . [or] without observance of procedure required by law" (emphasis added). In this case, the United States Court of Appeals for the Third Circuit held that the Federal Communications Commission conducted two licensing auctions for electromagnetic spectrum pursuant to seriously deficient, unlawfully promulgated rules. Those new rules effectively precluded significant participation by small businesses in the spectrum licensing auctions, contrary to 47 U.S.C. §§ 309(j)(3)(B) and (4)(D), which require the Commission to design its auctions so as to promote the participation of small businesses therein and to avoid the excessive concentration of licenses. Despite the APA's mandatory language, the Third Circuit concluded that it had discretion to decline to set aside the results of the licensing auctions, or order any other remedy for petitioners' effective exclusion from the auctions, in conflict with the decisions of other circuits. The question presented is:

Whether a reviewing court has the discretion under Section 706 of the APA to decline to set aside, or provide any remedy for, unlawful agency action?

PARTIES TO THE PROCEEDING BELOW

The petitioners in this case include Council Tree Investors, Inc., Bethel Native Corporation, and the Minority Media and Telecommunications Council.[1]

The respondents include the Federal Communications Commission and the United States of America.

The intervenors on the side of respondents include CTIA – The Wireless Association, T-Mobile USA, Inc. and Cellco Partnership d/b/a Verizon Wireless.

CORPORATE DISCLOSURE STATEMENT

No petitioner has a parent company and no publicly held company owns 10% or more of the stock of any petitioner.

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[1] At the time of the December 1, 2009 oral argument before the Third Circuit, Council Tree Investors, Inc. informed the court of its name change from Council Tree Communications, Inc., but this change was not reflected in the case caption of the court's opinion.

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PETITION FOR A WRIT OF CERTIORARI

Petitioners Council Tree Investors, Inc. ("Council Tree"), Bethel Native Corporation ("BNC"), and The Minority Media and Telecommunications Council respectfully petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Third Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-51a) is reported at 619 F.3d at 235.

JURISDICTION

The judgment of the court of appeals was entered on August 24, 2010. Pet. App. 1a. Justice Alito extended the time for filing the petition to and including December 22, 2010. No. 10A467. This Court has jurisdiction pursuant to 28 U.S.C. § 1254(1).

RELEVANT STATUTORY PROVISIONS

Reproduced in an appendix to this petition are the relevant provisions of (1) the Administrative Procedure Act, 5 U.S.C. §§ 500 *et seq.* ("APA"); and (2) the Communications Act of 1934, as amended, 47 U.S.C. §§ 151 *et seq.* ("Communications Act").

STATEMENT OF THE CASE

I. Introduction

This petition presents a question of vital importance concerning the remedy required under

the APA for unlawful agency action. In this case, the Third Circuit held that the Federal Communications Commission ("FCC" or "Commission") had conducted two important spectrum licensing auctions pursuant to unlawful rules. Those rules pervasively excluded small businesses, including petitioners, from competing in the auctions, contrary to key provisions of the Communications Act that require the FCC to take steps to prevent concentration of the nation's airwaves in the hands of large incumbent carriers. Although the Third Circuit set aside the rules as unlawfully promulgated, and did not question their devastating consequences for small businesses in the auctions, the court of appeals declined to set aside the auction results or order any other relief for petitioners' injuries. That decision was premised on that court's view that Section 706 of the APA – which provides that a reviewing court "shall . . . set aside" unlawful agency action – allows reviewing courts significant remedial discretion, including the authority to decline to set aside or otherwise remedy such unlawful action. That interpretation of the APA is the subject of deep and historic divisions within the circuits that should be resolved by this Court in this case.

II. Statutory/Regulatory Framework

1. The Communications Act of 1934, as amended, 47 U.S.C. §§ 151 *et seq.*, directs the FCC to auction licenses for publicly-owned electromagnetic spectrum. 47 U.S.C. § 309(j) (2006). Congress viewed the auctions as an opportunity to allow new entrants into a heavily concentrated telecommunications industry and, therefore, in order to prevent the largest and

best-financed incumbent companies from dominating licensing auctions, Congress directed the FCC to design an auction system that seeks to "promot[e] economic opportunity and competition . . . by avoiding excessive concentration of licenses and by disseminating licenses among a wide variety of applicants, including small businesses . . . ," while also seeking the "avoidance of unjust enrichment through the methods employed to award" licenses. *Id.* §§ 309(j)(3)(B), (C); *see also id.* § 309(j)(4)(D). Small business entities Congress intended to assist are classified by the FCC as "designated entities," 47 C.F.R. § 1.2110(a) (2005), also known in agency parlance as "DEs."

The FCC implemented these directives through a number of regulatory measures. To help DEs counteract the substantial financial advantages enjoyed by incumbents, FCC regulations grant DEs auction "bidding credits" that reduce the amounts winning DEs pay by a specified percentage. *Id.* § 1.2110(f) (2005). The amount of the credit varies with the average gross annual revenues for the preceding three years of the entity controlling the DE. *Id.* § 1.2110(f)(2)(i)-(iii) (2005). To avoid "unjust enrichment," however, the FCC imposes a graduated system of penalties on a DE that loses DE eligibility or sells its acquired spectrum licenses to a non-DE within a specified period of time after acquisition, a period set at five years for almost a decade prior to the rulemaking challenged in this case. Pet'rs Br. 7 n.7; *see also* 47 C.F.R. § 1.2111(d)(2) (2005).

At the same time, the Commission historically recognized that it was unrealistic to think that new entrant DEs could immediately amass enough capital

not only to build new wireless network facilities, but also to sell telecommunications services directly to customers in retail competition with large, entrenched incumbents. Consequently, FCC regulations and policies historically endeavored to promote competition by allowing DEs the flexibility to sell spectrum at wholesale and to lease substantial quantities of spectrum to third parties, without triggering the unjust enrichment penalties.[2] By allowing successful DE bidders to generate immediate sources of wholesale and resale revenue, the Commission enabled startup DEs to attract outside investors who would otherwise be unwilling to risk waiting for such new businesses to try to establish themselves in the retail marketplace against such long competitive odds. With such flexibility, DEs could use their licenses to compete with the largest incumbents through such means as alliances with other companies, already established in that marketplace, that have an abiding need for additional spectrum capacity.

2. The promulgation of these regulations, their subsequent amendment, and the licensing auctions themselves, are governed by the APA, 5 U.S.C.

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[2] Pet. App. 40a (quoting *In re Promoting Efficient Use of Spectrum Through Elimination of Barriers to the Development of Secondary Markets*, Report and Order and Further Notice of Proposed Rulemaking, 18 F.C.C.R. 20604, 20654-55 (2003)). The "leasing" model allows a *lessee* to use spectrum leased from a DE to provide service to consumers over technical facilities which that *lessee* has already constructed and owns, whereas the "wholesale" model calls for the DE that owns the spectrum to build out and operate new technical facilities and then *wholesale* spectrum capacity to third parties who provide service to consumers.

§§ 551(13), 553. Section 553 of the APA obligates agencies to publish in the Federal Register "[g]eneral notice of proposed rule making," including "either the terms or substance of the proposed rule or a description of the subjects and issues involved." 5 U.S.C. § 553(b)(3) (2006). These requirements "serve important purposes of agency accountability and reasoned decisionmaking," that are at the core of the APA. *Am. Med. Ass'n v. Reno*, 57 F.3d 1129, 1132 (D.C. Cir. 1995).

The statute further prohibits agency action that is "arbitrary [or] capricious," and creates a private right of action to challenge agency violations of law. 5 U.S.C. §§ 702, 706(2)(A) (2006). As part of the Act's enforcement regime, Section 706 mandates that a court reviewing challenged agency action

> shall—(1) compel agency action unlawfully withheld or unreasonably delayed; and (2) hold unlawful and set aside agency action . . . found to be . . . not in accordance with law . . . [or] without observance of procedure required by law.

Id. §§ 706(1), 706(2)(A), (D).

III. Procedural History

1. In 2006, the FCC conducted a major auction (referred to as "Auction 66") for licenses for large amounts of highly desirable electromagnetic spectrum allotted for the provision of advanced wireless services.[3] Petitioners and other DEs

[3] The FCC had begun planning for Auction 66 many years earlier. *See generally Second Report and Order*, ET Docket No. 00-258, 17 F.C.C.R. 23193 (2002).

engaged in extensive preparations to participate in the auction, negotiating partnerships and working to obtain investment funding from various sources based on the then-existing DE rules. *See* CA-JA 1267-68, 1277, 1537-38.[4]

In February 2006, just three months before applications were due for the scheduled June 2006 commencement of Auction 66, the FCC announced that it was undertaking a rulemaking to make certain limited modifications to the DE program, to be applied to the upcoming Auction 66 and all subsequent auctions.[5] In particular, the Commission proposed to preclude certain material relationships between DEs and large, in-region incumbent wireless carriers and also requested comment on whether to extend any such limitations to DE relationships with other large companies with significant communications interests. The FCC gave no indication that it was contemplating any larger changes, and petitioners Council Tree and BNC continued to prepare for Auction 66.

However, in April 2006, a little more than two weeks before Auction 66 applications were due, the

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[4] The administrative record contained in the Joint Appendix and Supplemental Joint Appendix before the Third Circuit is hereby cited to as "CA-JA" or "CA-SJA," respectively.

[5] *See Further Notice of Proposed Rule Making*, WT Docket No. 05-211, 21 F.C.C.R. 1753 (2006). CA-JA 60.

FCC issued final rules[6] that bore no resemblance to those in the proposed rulemaking and instead dramatically altered the DE regulations in ways that substantially harmed DEs, ultimately preventing petitioners from competing with the incumbent carriers in Auction 66 and any subsequent licensing auction. In particular, the new rules:

(1) *doubled* the unjust enrichment penalty repayment period from five to ten years ("Ten Year Rule") and made corresponding changes in the related schedule of graduated repayment penalties over those ten years, including the imposition of a 100 percent bid credit repayment obligation (plus interest) during the first five years;[7]

(2) *eliminated* DE eligibility altogether for any entity that leased or resold (including on a wholesale basis) to third parties more than 50 percent of the aggregate spectrum capacity won at auction ("50 Percent Rule");[8] and

(3) through changes in the rules for determining a DE's gross revenues (and, therefore, its

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[6] *Second Report and Order and Second Further Notice of Proposed Rule Making*, WT Docket No. 05-211, 21 F.C.C.R. 4753 (2006) ("*Second R&O*"), CA-JA 82, *recon. granted in part and denied in part sua sponte, Order on Reconsideration of the Second Report and Order*, WT Docket No. 05-211, 21 F.C.C.R. 6703 (2006) ("*First Reconsideration Order*"), CA-JA 142, *recon. denied, Second Order on Reconsideration of the Second Report and Order*, WT Docket No. 05-211, 23 F.C.C.R. 5425 (2008) ("*Second Reconsideration Order*"), CA-SJA 29.

[7] *See* 47 C.F.R. § 1.2111(d)(2)(i) (2006) (now vacated).

[8] *See id.* § 1.2110(b)(3)(iv)(A) (now vacated).

eligibility for DE status), effectively limited DEs to leasing or reselling (including on a wholesale basis) to any single third party no more than twenty-five percent of the aggregate spectrum capacity won at auction ("25 Percent Rule").[9]

2. Petitioners immediately challenged the new rules as adopted in contravention of the APA notice and comment provisions and as substantively arbitrary and capricious. In a petition for reconsideration (and expedited request for stay) filed with the FCC, CA-JA 1279 and 1245, respectively, petitioners pointed out that the 11th hour rule changes had emerged without warning from a proceeding that was originally focused primarily on whether to limit large incumbent wireless service provider involvement in the DE program. *See id.* at 1281 and 1285.

Petitioners further pointed out that substantively, the new rules would have a devastating effect on DEs' business plans and access to capital in Auction 66, by driving away those able and willing to invest in DEs. *Id.* at 1254-1255. Petitioners emphasized that no rational investor would tolerate having to retain ownership of an expensive asset for *ten years* without a viable exit plan in a field as dynamic as telecommunications. *Id.*

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[9] The rule accomplished this result by attributing to each DE the gross revenues of any company to which it leased or resold this amount of spectrum capacity, which would in most cases have the effect of putting the DE's gross revenues above the maximum level permitted for DE status eligibility. *See id.* § 1.2110(b)(3)(iv)(B) (2006).

Moreover, the 50 Percent Rule effectively required all DEs to use at least half of their spectrum to compete directly with entrenched incumbents in the *retail* marketplace, where an incumbent's advantages are most pronounced (*e.g.*, advertising, storefront presence, branding). *See id.* at 1524, 1558. The combination of rules deprived DEs of flexibility essential to attracting start-up capital, causing the immediate withdrawal of petitioners' private equity investors and significant strategic partners cultivated over many months. *See id.* at 1527, 1538.[10]

3. The FCC declined to grant petitioners' reconsideration and stay requests, although some Commissioners expressed ambivalence and concern about the new DE rules. FCC Chairman Kevin Martin stated his belief that these "last-minute" changes were not "needed" but that he agreed to them only to "obtain the support" necessary to ensure that the Auction 66 would be held in the Summer of 2006. CA-JA 166. Commissioner Jonathan Adelstein, who had earlier noted that the rule changes were made on an "incredibly aggressive" timetable, *id.* at 80, worried on reconsideration that they, and the FCC's subsequent "legal maneuvering" in the "troubled proceeding," might "prove to be the undoing of [the FCC's] most significant auction in 10 years." *Id.* at 168.

Petitioners sought an emergency stay of the rule changes and of Auction 66 from the Third Circuit.

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[10] In fact, the rule revisions prevented Council Tree from bidding to implement a business plan that called for the emergence of a new nationwide competitive wireless carrier network. Pet'rs Supp. App. V, Tab 1.

The court of appeals denied the stay and the auction proceeded. Pet. App. 24a-26a.

4. Petitioners' objections proved prophetic, as the new rule changes ultimately had a dramatic impact on DE performance not only at Auction 66, but also at a second major spectrum licensing auction, "Auction 73," conducted pursuant to the new DE rules early in 2008. Historically, DEs had won on average 70% of auction licenses, measured by value. *Id.* at 26a-27a.[11] But DEs won just 4% of the nearly $14 billion worth of auctioned licenses in Auction 66. *Id.* at 26a. In contrast, four large bidders won 78% of the total dollar value of the licenses auctioned. Pet'rs Supp. App. III, Tab 1, Exh. H.

Those results were so startling that the Office of Advocacy of the U.S. Small Business Administration asked the FCC to suspend application of the demonstrably harmful new rules to Auction 73. Pet'rs Supp. Br. 8 n.12. The FCC summarily rejected that request,[12] and the results in Auction 73 were even worse. That auction generated more than $19 billion in winning bids, but DEs' percentage of the total dollar value fell even more precipitously, to 2.6%. Pet. App. 27a. Just two companies, Verizon Wireless and AT&T Wireless, captured more than 84% of the total dollar value of the licenses auctioned. Pet'rs Supp. App. III, Tab 1, Exh. I.

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[11] That is, in an auction that garnered $100 million in winning bids, DEs typically purchased approximately $70 million worth of spectrum.

[12] *See Second Report and Order*, WT Docket No. 06-150, 22 F.C.C.R. 15289, 15472 n.1083 (2007).

Thus, despite Congress's intent that the auctions be structured to increase competition and avoid concentration of spectrum licenses in the hands of a few dominant carriers, under the new rules, by 2008, only four companies controlled 90% of subscribers in the mobile telephone market, up from 62.6% controlled just five years earlier by the top four companies.[13]

5. Petitioners sought judicial review of the rule changes and both licensing auctions in the Third Circuit.[14] On August 24, 2010, the Third Circuit issued its opinion, striking down the most significant rule changes but declining to vacate the license sales or provide any remedy for petitioners' effective exclusion from the auctions.

a. The court first narrowly upheld the 25 Percent Rule, although it found it a "close" question whether the rule was arbitrary and capricious, given its effect

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[13] *Compare Annual Services Report and Analysis of Competitive Market Conditions with Respect to Commercial Mobile*, Ninth Report, WT Docket No. 04-111, 19 F.C.C.R. 20597, 20697 (2004) (reporting 2003 subscriber by carrier data), *with Annual Services Report and Analysis of Competitive Market Conditions with Respect to Commercial Mobile*, Fourteenth Report, WT Docket No. 09-66, 25 F.C.C.R. 11407, 11648 (2010) (reporting 2008 subscriber by carrier data).

[14] The court ruled that petitioners' initial petition was premature, as the Commission had not yet issued a final order disposing of petitioners' request for reconsideration of the rule changes. *See Council Tree Comm'ns v. FCC*, 503 F.3d 284, 293 (3d Cir. 2007). When the Commission continued to fail to act on the reconsideration petition, petitioners sought a writ of mandamus, after which the Commission finally denied reconsideration. *Second Reconsideration Order*, *supra* note 6. Petitioners then filed the present case in the Third Circuit.

on DEs' ability to raise capital and the FCC's limited justification for the rule. Pet. App. 34a.

Turning to the 50 Percent and Ten Year Rules, the court expressed serious doubt whether either was substantively lawful. The panel "note[d] that the FCC does not appear to have thoroughly considered the impact of the extended repayment schedule on DEs' ability to retain financing." *Id.* at 46a n.10. It further found that the Commission was "confused" about "the maximum period for which investors are willing to lock up their capital (before being able to liquidate the spectrum license, in the event the DE proves unprofitable) . . . ." *Id.* at 46a-47a n.10. Likewise, the court criticized the agency's "inattention to the nature of the wireless wholesaling business," in which a DE would "build and operate" new, wireless transmission facilities and then sell that new capacity to other existing companies, thereby promoting competition. *See id.* at 42a n.8.

Ultimately, however, the court concluded that it did not have to decide whether the rule changes were arbitrary and capricious, because they were made in clear violation of the APA's notice and comment requirements. *Id.* The court found that the "contrast could not be more stark between the transparent discussion of [the issues in a prior rulemaking] and the run up to the rules promulgated in 2006." *Id.* at 41a. In this case, the Further Notice of Proposed Rulemaking "had not so much as hinted that" the Commission was contemplating anything like the 50 Percent Rule. *Id.* at 39a. Similarly, the court found that the FCC had failed to provide even "inferential notice" of the Ten Year Rule, *id.* at 44a, observing that "[i]ndeed, no commenter manifested

an understanding that the FCC was considering changing the existing repayment schedule." *Id.* at 45a.

b. The court then turned to remedy. The FCC and intervenors had argued that, even if the rules had been issued in violation of the APA, the Third Circuit should provide no remedy for petitioners' injuries, but should instead leave undisturbed both the auction results and the illegally issued rules, while remanding the case to give the Commission an opportunity to retain the rules pursuant to proper procedures. *See id.* at 47a. In the alternative, the Commission and intervenors argued that if petitioners were entitled to a remedy for their injuries, the court should either vacate the rules and leave the auctions intact, or follow precedent from the D.C. Circuit and remand the case to allow the Commission to craft appropriate alternative relief relating to the auctions. *Id.* at 49a; *see also* Resp'ts Supp. Br. 33-34 (citing *City of Brookings Mun. Tel. Co. v. FCC*, 822 F.2d 1153, 1171-72 (D.C. Cir. 1987)); Intervenors CTIA - The Wireless Association and T-Mobile USA, Inc. Supp. Br. 16-17 (citing, *inter alia*, *Freeman Eng'g Assocs. v. FCC*, 103 F.3d 169 (D.C. Cir. 1997)).

Petitioners, on the other hand, argued that a remand without vacatur was impermissible, noting that "[t]he APA's command that '[t]he reviewing court shall . . . set aside [unlawful] agency action,' 5 U.S.C. § 706(2)(A), means quite straightforwardly, that 'a "reviewing court" . . . "shall" – **not may** – "hold unlawful and set aside" the agency action. Setting aside means vacating; no other meaning is apparent.'" Pet'rs Supp. Br. 25 n.43 (quoting

Checkosky v. SEC, 23 F.3d 452, 491 (D.C. Cir. 1994) (Randolph, J., dissenting in part) (emphasis in original) (some internal citations omitted)). Petitioners further insisted that a "prospective-only" remedy that set aside the rules for future auctions, but provided no remedy for the past harm done to DEs, would be entirely inadequate. *Id.* at 36. Instead, they asked the Third Circuit to set aside the rules and, as this Court had done in *FCC v. NextWave Personal Communications Inc.*, 537 U.S. 293 (2003), vacate the auction results. Pet'rs Supp. Br. at 25-26; Pet'rs Reply Br. 23, 28.

In light of the "serious" deficiencies in the rulemaking process, the Third Circuit denied the Commission's request for remand without vacatur of the Ten Year Rule and the 50 Percent Rule ("Vacated Rules"), without resolving there petitioners' claim that the plain language of the APA deprived the court of the discretion to decline to set aside an unlawful agency action. Pet. App. 49a & n.13. The court did not hesitate, however, to treat its decision of whether to set aside the rest of the challenged agency action – the FCC's licensing auctions conducted pursuant to the Vacated Rules – as a matter of equitable discretion. It concluded that the difficulties and assumed inequities of reinitiating the spectrum license sales justified providing no remedy at all with respect to the auctions themselves. *Id.* at 48a. The court did not dispute that the FCC has been required to vacate the results of unlawfully conducted auctions in the past, as demonstrated in *NextWave*. And the court acknowledged that it would be possible to mitigate the impact of a rescission by allowing winning bidders to maintain their licenses "unless

and until they are won by another bidder at re-auction." *Id.* Nonetheless, the court concluded that "it would be imprudent and unfair to order rescission of the auction results." *Id.* at 49a.

At the same time, the court declined to order any other relief to compensate for the unfairness to petitioners inherent in refusing to vacate the spectrum license sales or to remand the case to the FCC to consider whether some alternative form of relief was appropriate and available to address petitioners' injuries. *See id.*

REASONS FOR GRANTING THE WRIT

This case raises important questions concerning the remedy required by Section 706 of the APA, 5 U.S.C. § 706, when the court finds that a federal agency has acted unlawfully. The decision below adds to a deep and historic division of authority within the circuits.

I. This Court Should Resolve The Division Among The Courts Of Appeals On The Important Question Of Whether Section 706 Deprives Reviewing Courts Of The Discretion To Decline To Set Aside Unlawful Agency Action.

This case presents the Court with an opportunity to address and resolve an unsettled issue of profound and recurring importance within the field of administrative law. Under Section 706, a "reviewing court *shall*— (1) *compel* agency action unlawfully withheld or unreasonably delayed; and (2) hold unlawful *and set aside* agency action . . . found to be— (A) arbitrary, capricious, an abuse of discretion,

or otherwise not in accordance with law; . . . [or] (D) without observance of procedure required by law." 5 U.S.C. § 706 (emphasis added). Some circuits have held that this seemingly mandatory language is permissive, allowing courts to exercise equitable discretion to decline to set aside unlawful agency action. Others have read the same language to mean precisely the opposite, construing "shall" to preclude any room for equitable discretion. The conflict is considered and will not be resolved absent a decision from this Court. Accordingly, as a leading treatise has noted, "[t]he Supreme Court needs to resolve the growing dispute about the range of remedies available to a reviewing court when the court detects one or more flaws or gaps in an agency's reasoning in support of a rule." Richard J. Pierce, Jr., *Administrative Law Treatise* § 7.13, at 693 (5th ed. 2010).

A. The Circuits Are Intractably Divided Over Whether Courts Retain Discretion To Refuse To Set Aside Unlawful Agency Action Under Section 706.

For many years after enactment of the APA, the practice of vacating unlawful agency action as a matter of course was "generally accepted and relatively uncontroversial." American Bar Association, Section of Administrative Law and Regulatory Practice and Business Law, Report to the

House of Delegates 1, 1 (1997).[15] By the early 1990s, however, the D.C. Circuit had confirmed its departure from the plain language of Section 706 in favor of exercising equitable discretion to remedy APA violations. That practice has also been adopted by the Ninth and now the Third. However, the Tenth Circuit has directly rejected these Circuits' interpretation of Section 706, concluding that the provision's mandatory language means what it says.

1. Under the D.C. Circuit's "remand without vacatur" practice, an "inadequately supported rule . . . need not necessarily be vacated." *Comcast Corp. v. FCC*, 579 F.3d 1, 8 (D.C. Cir. 2009) (quoting *Allied-Signal, Inc. v. U.S. Nuclear Regulatory Comm'n*, 988 F.2d 146, 150 (D.C. Cir. 1993)). Instead, "[t]he decision whether to vacate depends on the seriousness of the [rule's] deficiencies . . . and the disruptive consequences of an interim change that may itself be changed." *Comcast*, 579 F.3d at 8 (quoting *Allied-Signal*, 988 F.2d at 150-51); *see, e.g.*,

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[15] *See also* Merrick B. Garland, *Deregulation and Judicial Review*, 98 Harv. L. Rev. 505, 568 (1985) ("Traditionally, courts faced with an arbitrary and capricious regulatory decision . . . normally vacate[] the decision and remand[] the matter to the agency for further proceedings 'consistent with' the court's opinion."); Ronald M. Levin, *Vacation at Sea: Judicial Remedies and Equitable Discretion in Administrative Law*, 53 Duke L.J. 291, 298 (2003) ("Until recently, reviewing courts routinely vacated agency actions that they found to have been rendered unlawfully. That practice was generally accepted and essentially taken for granted."); Richard J. Pierce, Jr., *Seven Ways to Deossify Agency Rulemaking*, 47 Admin. L. Rev. 59, 75 (1995) ("Until the 1990s, a reviewing court routinely vacated and remanded an agency rule if the court held the rule arbitrary and capricious . . . .").

Natural Res. Def. Council v. EPA, 489 F.3d 1364, 1374-75 (D.C. Cir. 2007); *see In re Barr Labs., Inc.*, 930 F.2d 72, 74-76 (D.C. Cir. 1991).

Judges within the D.C. Circuit have objected that the court's remand without vacatur practice cannot be squared with the plain language of Section 706. Judge Randolph, for example, has argued the APA requires "in the clearest possible terms" that a reviewing court faced with an unlawful "agency decision 'shall' – **not may** – 'hold unlawful and set aside' the agency action." *Checkosky v. SEC*, 23 F.3d 452, 491 (D.C. Cir. 1994) (Randolph, J., dissenting in part) (emphasis in original). Remanding without vacating, therefore, is "contrary to law. It rests on thin air. No statute governing judicial review of agency action permits such a disposition and the controlling statute – 5 U.S.C. § 706(2)(A) – flatly prohibits it." *Id.* at 490; *accord Comcast Corp.*, 579 F.3d at 10 (Randolph, J., concurring) ("'Set aside' means vacate, according to the dictionaries and the common understanding of judges, to whom the provision is addressed. And 'shall' means 'must.' I see no play in the joints."); *Milk Train, Inc. v. Veneman*, 310 F.3d 747, 757-58 (D.C. Cir. 2002) (Sentelle, J., dissenting).

The Ninth Circuit has adopted the same interpretation of Section 706, refusing to set aside unlawful agency action for equitable reasons. *See, e.g., Idaho Farm Bureau Fed'n v. Babbitt*, 58 F.3d 1392, 1405 (9th Cir. 1995) ("Ordinarily when a regulation is not promulgated in compliance with the APA, the regulation is invalid. However, when equity demands, the regulation can be left in place while the agency follows the necessary procedures.") (citation

omitted); *W. Oil and Gas Ass'n v. EPA*, 633 F.2d 803, 813 (9th Cir. 1980).[16]

The Third Circuit followed suit in this case. Although the court vacated the unlawfully promulgated rules, it made clear that it did not do so under the compulsion of the mandatory language of Section 706, but rather, because it viewed vacatur as the most appropriate remedy. *See* Pet. App. 49a n.13 (declining to exercise any discretion court might have to refuse vacatur). At the same time, the panel refused to "exercise [its] equitable authority to rescind" the auctions conducted pursuant to the unlawful rules, *id.* at 47a, because it considered that result "imprudent and unfair," *id.* at 49a, and not in "the public interest." *Id.* at 48a. Accordingly, while the court of appeals found no need to decide whether it had discretion to refuse to vacate the *rules*, it did not hesitate to treat the proper remedy for the unlawful auctions as a matter of discretion, consistent with the law in the Ninth and D.C. Circuits.

2. That assertion of discretionary authority has been squarely rejected by the Tenth Circuit. In *Forest Guardians v. Babbitt*, 174 F.3d 1178 (10th Cir.

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[16] The First, Fifth, and Federal Circuits have taken a more limited, phased approach, holding in certain cases that courts have discretion to remand a case to an agency for a fuller explanation of the agency's rationale, without deciding whether the agency action was unlawful, or vacating the agency action pending further proceedings on remand. *See, e.g., Cent. Me. Power Co. v. FERC*, 252 F.3d 34, 48 (1st Cir. 2001); *Cent. & S. W. Servs., Inc. v. EPA*, 220 F.3d 683, 692 (5th Cir. 2000); *Nat'l Org. of Veterans' Advocates, Inc. v. Sec'y of Veterans Affairs*, 260 F.3d 1365, 1380 (Fed. Cir. 2001).

1999), the Tenth Circuit was faced with the Department of the Interior's decision to unlawfully withhold, beyond an expired statutory deadline, a determination on the critical habitat of an endangered species. The court acknowledged that the D.C. Circuit had, in similar circumstances, concluded that relief "'does not necessarily follow a finding of a violation,'" but rather called for the exercise of remedial discretion. *Id.* at 1191 (quoting *In re Barr Labs., Inc.*, 930 F.2d 72, 74 (D.C. Cir. 1991)). The Tenth Circuit, however, rejected that conclusion:

> In light of the clear command of § 706, *we cannot agree*. Section 706 requires that a reviewing court 'shall compel agency action . . . unreasonably delayed,' and despite the *In re Barr* court's contrary conclusion, we believe that once a court deems agency delay unreasonable, it *must compel* agency action.

174 F.3d at 1191 (emphasis added).

The Federal Circuit has expressed the same understanding. In *PGBA, LLC v. United States*, 389 F.3d 1219 (Fed. Cir. 2004), the court contrasted the discretionary remedial standard created by the text of the Administrative Dispute Resolution Act of 1996 ("ADRA"), 28 U.S.C. § 1491(b)(2) (providing that "the courts *may* award any relief the court considers proper") (emphasis added), with the mandatory requirement of Section 706. 389 F.3d at 1224. The plaintiff in *PGBA* argued that, because the ADRA requires courts to review agency contracting decisions "pursuant to the standards set forth in section 706," 28 U.S.C. § 1491(b)(4), and because Section 706

leaves courts no "discretion to decide whether to set aside arbitrary and capricious government action," the ADRA likewise requires courts to set aside any contracting decision found to be unlawful. 389 F.3d at 1225. The Federal Circuit did not question that the plaintiff's construction of Section 706 was correct. Instead, it proceeded on the premise that if Section 706's remedial standards applied under the ADRA, unlawful contracting decisions must be set aside, and asked solely whether the ADRA's reference to Section 706 "merely incorporates the arbitrary and capricious standard of review from Section 706(2)(A), or whether it means that the reviewing court must set aside any action it finds arbitrary or capricious without consideration of the relative harms of such action." *Id.* [17]

At the same time, other courts, including this Court, have continued the tradition of vacating unlawful agency action as a matter of course, without directly addressing the question of discretion. *See AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 392 (1999) ("Because the Commission has not interpreted the terms of the statute in a reasonable fashion, we *must vacate* 47 CFR § 51.319 (1997).") (emphasis added); *Nat'l Ass'n of State Util. Consumer Advocates v. FCC*, 457 F.3d 1238, 1257-58 (11th Cir. 2006); *Ohio River Valley Envtl. Coalition v. Kempthorne*, 473 F.3d 94, 99, 104 (4th Cir. 2006); *Waterkeeper Alliance, Inc. v. EPA*, 399 F.3d 486, 524 (2d Cir. 2005); *Wall v. EPA*, 265 F.3d 426, 427 (6th Cir. 2001);

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[17] The court ultimately concluded that Congress imported only Section 706's "arbitrary and capricious" standard of review into the ADRA, leaving remedies to be controlled by the ADRA's own broader remedial provision. *See* 389 F.3d at 1226.

Iowa Utils. Bd. v. FCC, 120 F.3d 753, 801 (8th Cir. 1997), *aff'd in part and rev'd in part on other grounds sub nom. AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366 (1999).

3. The conflict among the circuits is mature and entrenched, incapable of resolution except by this Court. In *Forest Guardians*, the Tenth Circuit acknowledged, but rejected, the contrary authority of the D.C. Circuit, 174 F.3d at 1190-91, and denied a petition for rehearing en banc to reconsider that decision. *Id.* at 1180. The D.C. Circuit likewise has persisted in its interpretation of the APA, despite repeated objections from its own judges, *see supra* pp. 17-18, and the contrary authority in the Tenth Circuit. *See Cobell v. Norton*, 240 F.3d 1081, 1096 n.4 (D.C. Cir. 2001) (noting, but disagreeing with, the Tenth Circuit's contrary position).

This conflict, and the broader uncertainty regarding the proper construction and application of the APA's remedial authority, should not be allowed to persist any longer. The APA was enacted to establish a uniform regime of judicial review of agency action. Its operation should not vary dramatically depending on whether the agency action is challenged in Denver or Dover. The present disuniformity invites forum shopping and unequal treatment of similarly situated individuals based on nothing more than accidents of geography, exactly what Congress intended to prevent by establishing a single, national standard in Section 706.

This case presents an ideal vehicle for resolving this dispute. The conflict in the circuits' interpretation of Section 706 is squarely presented by

the facts of this case and is outcome determinative. Here, the Third Circuit conducted a painstaking and careful review of the administrative record and found the agency's actions clearly unlawful. *See* Pet. App. 33a-46a. The only remedial question was whether that unlawful action should be set aside in whole, in part, or not at all. The court acknowledged petitioners' argument that "the APA requires us to 'hold unlawful *and set aside*' any such agency action," *id.* at 49a n.13 (emphasis in original) (citations omitted), as well as the FCC's defense of the D.C. Circuit's remand without vacatur jurisprudence. *Id.* at 49a. And the choice between those competing constructions of the statute determined the outcome of petitioners' challenge to the unlawfully conducted auctions in this case.

B. Whether Section 706 Permits Courts To Decline To Set Aside Unlawful Agency Action Is A Question Of Recurring Importance, With Profound Implications For The Nation's Telecommunications Policy As Applied In This Case.

Certiorari is further warranted because the proper interpretation of the APA's remedial provision is a frequently recurring question of enduring national importance. The court of appeals' misapplication of Section 706 to this case, moreover, has broad and damaging consequences for the implementation of the nation's telecommunications policy.

1. The scope of courts' remedial discretion under the APA is a question relevant to the disposition of thousands of APA suits arising in a multitude of

contexts. What had historically been a simple remedial matter for reviewing courts, namely to set aside all unlawful agency action, is currently plagued by uncertainty and confusion. In the absence of guidance from this Court, lower courts have been left to grapple with the glaring conflict between the mandatory plain language of Section 706 and departures from that language in certain circuits, including now the Third.

The present uncertainty stands as a deterrent to challenges to even the most blatant agency violations. As things now stand, even those litigants with the resolve and resources to challenge agency action they believe to be unlawful must weigh the substantial costs of a challenge against highly uncertain benefits, where remedial discretion may effectively deny them meaningful relief.

At the same time, the prevalence of doctrines like "remand without vacatur" in some circuits reduces agencies' incentives to adhere carefully to the procedural requirements of the APA, knowing that there is a real chance that if a court finds the agency's conduct unlawful, it will nonetheless decline to set the action aside. It takes little imagination to conclude, for example, that if the FCC knew that licensing auctions conducted pursuant to unlawful rules would ultimately be "set aside" by a reviewing court, the rules vacated in this case would never have

seen the light of day.[18] As noted above, p. 9, at the time of adoption of the Vacated Rules, FCC Commissioner Adelstein was acutely aware that the FCC's actions in the "troubled proceeding" that produced those rules could eventually lead to an overturn of then pending Auction 66. Future FCC Commissioners, faced only with the prospect of the vacatur of unlawfully adopted rules far down the judicial road, with agency "licenses" issued under those unlawful rules insulated by equitable considerations, would have no reason to treat seriously Commissioner Adelstein's concern.

2. The court of appeals' misapplication of Section 706 particularly warrants review in this case because of its detrimental effects on the nation's telecommunications policy. The unlawful agency action in this case directly and substantially harmed small business participation in two of the most important spectrum licensing auctions in the history of this country, encompassing vital nationwide, regional, and local licenses that govern the use of vast amounts of very valuable spectrum.[19] In the

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[18] *See* Daniel B. Rodriguez, *Of Gift Horses and Great Expectations: Remands Without Vacatur in Administrative Law*, 36 Ariz. St. L.J. 599, 620 (2004) ("[T]here are good reasons to suppose that an agency will be motivated both *ex ante* and *ex post* to adopt rules in a manner that will pass muster if they know that they face the prospect of vacatur if they fail.").

[19] Commissioner Adelstein aptly characterized Auction 66 as the agency's "most significant auction in 10 years," CA-JA 168, and referred to the spectrum made available in Auction 73 as "the finest crown jewels the FCC has to put up for auction." *Second Report and Order*, WT Docket No. 06-150, 22 F.C.C.R. 15289, 15564 (2007).

absence of effective judicial relief, the damage to the public in the form of further entrenchment of incumbents and the loss of benefits, including the lower costs and greater innovation produced by competition, will be deep and irreparable. Such auctions are few and far between, and the licenses confirmed by the Third Circuit here will remain in the hands of large incumbents for the foreseeable future.[20]

C. The Plain Language Of Section 706 Deprives Courts Of Any Equitable Discretion To Refuse To Set Aside Unlawful Agency Action.

The decision below should also be reviewed by this Court because, under the plain language of the statute and this Court's precedents, Section 706 allows reviewing courts no discretion to refuse to set aside unlawful agency action.

Section 706 states in plain and unambiguous terms that courts "shall . . . set aside" actions taken by agencies in violation of the APA. 5 U.S.C. § 706(2)(A) (2006). Numerous decisions of this Court have made clear that "shall" means "shall" (not "may") and leaves no room for the exercise of discretion. *See, e.g., Nat'l Ass'n of Home Builders v. Defenders of Wildlife*, 551 U.S. 644, 661 (2007) (language in the Clean Water Act, providing that the EPA "shall approve" an application seeking to transfer permitting authority from the EPA to a state unless the EPA finds the state cannot perform nine

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[20] *See, e.g.*, 47 C.F.R. § 27.13 (setting ten-year license term) and 47 C.F.R. § 27.14 (setting criteria for renewal).

functions listed in the statute, "is mandatory and the list exclusive; if the nine specified criteria are satisfied, the EPA *does not have the discretion* to deny a transfer application") (emphasis added); *Lopez v. Davis*, 531 U.S. 230, 241 (2001) (noting Congress' "use of a mandatory 'shall' . . . to impose *discretionless* obligations") (emphasis added); *Lexecon, Inc. v. Milberg Weiss Bershad Hynes & Lerach*, 523 U.S. 26, 35 (1998) ("the mandatory 'shall' . . . normally creates an obligation *impervious to judicial discretion*") (emphasis added).

Indeed, this Court need look no further than the immediately preceding section of the APA for confirmation that Congress uses "may" when it wants to grant permissive authority to an agency or reviewing court. Section 705 states that an agency "*may* postpone the effective date of action taken by it" and a reviewing court "*may* issue all necessary and appropriate process to postpone" such an effective date. 5 U.S.C. § 705 (emphasis added).

Consistent with the APA's plain meaning, this Court has consistently observed that the remedy established by Section 706 is mandatory. In *Federal Power Commission v. Transcontinental Gas Pipe Line Corp.*, this Court made clear that "[i]f the . . . decision of the agency 'is not sustainable on the administrative record made, then the . . . decision *must* be vacated and the matter remanded . . . for further consideration.'" 423 U.S. 326, 331 (1976) (*quoting Camp v. Pitts*, 411 U.S. 138, 143 (1973) (emphasis added)). To a similar effect is the seminal administrative law case *Citizens to Preserve Overton Park v. Volpe*, which stated that "in *all* cases agency action *must* be set aside if the action was 'arbitrary,

capricious, an abuse of discretion, or otherwise not in accordance with law' or if the action failed to meet statutory, procedural, or constitutional requirements." 401 U.S. 402, 413-14 (1971) (citing Section 706(2)(A-D)) (emphasis added); *see also AT&T Corp. v. Iowa Utils. Bd.*, *supra* p. 21, 525 U.S. at 392.

This does not mean that every minor flaw in an agency's administration of its duties requires courts to set aside the resulting rule or other action. The final clause of Section 706 specifically provides that "due account shall be taken of the rule of prejudicial error." 5 U.S.C. § 706 (2006). But where, as here, unlawful agency action has clearly prejudiced a party,[21] Congress has itself determined that the appropriate remedy is to set aside the agency action, leaving no room for any court to reach the contrary judgment.

II. The Third Circuit's Decision To Deny Any Relief At All Independently Warrants Review.

Certiorari is further warranted to decide whether, even if Section 706 permits equitable

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[21] The court below did not find that the agency's violation of notice and comment, or its conduct of the auctions pursuant to the unlawfully issued rules, was non-prejudicial. Nor could it. Rather, the court recognized that the errors were "serious." Pet. App. 50a. Those violations substantially harmed DEs by driving away funding sources through the sudden imposition of a ten-year exit horizon, unacceptable on its face for rational investors in a dynamic, fast-paced industry, and devastating business plans by substituting the rigid 50 Percent Rule for the well established and essential flexibility provided by wholesaling/leasing models.

discretion to decline to set aside unlawful agency action, the statute nonetheless requires the reviewing court to provide an alternative available remedy, which the Third Circuit declined to do in this case, placing it in conflict with the decisions of other courts.

A. The Third Circuit's Denial Of Any Relief At All Conflicts With The Law Of The D.C. Circuit And The Decisions Of This Court.

The Third Circuit did not question that the auctions in this case – conducted pursuant to unlawfully issued rules – constituted unlawful agency action subject to Section 706's "shall . . . set aside" command.[22] The court of appeals nonetheless not only refused to "set aside" the auction results, but declined to provide any remedy at all to petitioners injured by the unlawful agency action. The court did so despite the FCC's and the intervenors' acknowledgement that in prior similar cases, the D.C. Circuit had required the Commission to provide alternative remedies when that Circuit had refused to vacate the results of similar unlawful agency action. *See supra* p. 13. The holding in this case is incompatible with those decisions, the text and purposes of the APA, and the decisions of this Court.

1. The D.C. Circuit has recognized that a party who "makes out its case under the APA is *entitled to remedy*." *Am. Bioscience Inc. v. Thompson*, 269 F.3d

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[22] An agency's award of a "license" pursuant to an auction, like an agency's adoption of a "rule," is "agency action" under 5 U.S.C. § 551(13).

1077, 1084 (D.C. Cir. 2001) (emphasis added). Thus, in other cases involving FCC action found unlawful under the APA, the D.C. Circuit has required the Commission to provide alternative remedies, even when the court has declined to set aside the unlawful agency action directly.

For example, in *City of Brookings Municipal Telephone Company v. FCC*, *supra* p. 13, the D.C. Circuit held that the FCC acted arbitrarily and capriciously in changing the settlement process for allocating revenue among carriers for interstate telephone calls. The changes had been implemented, and had been used to divide revenue among carriers for some time by the date the D.C. Circuit rendered its decision. The Court therefore declined to "order[] the reassessment of settlement payments made under" the invalid rules, because doing so would "disrupt the settlement process" and "cause economic hardship" for some companies. 822 F.2d at 1171. However, that did not lead the court to hold that no relief should be afforded those injured by the unlawful rules. Instead, the court ordered the FCC to decide "how best to accommodate these various interests in light of the proceedings on remand." *Id.* at 1172.

The D.C. Circuit reached the same conclusion in *Freeman Engineering Associates v. FCC*, *supra* p. 13. There, the court considered the FCC's system of distributing radio spectrum. At the time, the FCC provided a "pioneer's preference" for companies developing innovative services. 103 F.3d at 174. The D.C. Circuit held that the Commission had arbitrarily and capriciously applied its pioneer preference rules to deny Qualcomm a preference, and

remanded to the FCC "for further proceedings to remedy" the violation. *Id.* at 180. While the case was on remand, Congress amended the relevant legislation, leading the Commission to believe that it was required to deny Qualcomm a preference. The Commission subsequently auctioned off some of the spectrum Qualcomm had sought to another company, Sprint. When Qualcomm appealed, the D.C. Circuit held that the Commission had misconstrued the intervening legislation and violated the court's prior mandate in declining to grant Qualcomm spectrum in accordance with the preference to which it was entitled. *Qualcomm, Inc. v. FCC*, 181 F.3d 1370, 1376 (D.C. Cir. 1999). Although the Court did not order the FCC to vacate the auction of spectrum to Sprint, it did not – as the Third Circuit did here – conclude that Qualcomm was entitled to no relief at all for its injuries. Instead, the D.C. Circuit ordered the FCC to provide an alternative remedy, requiring it to "take prompt action to identify a suitable spectrum and award QUALCOMM the license for it." *Id.* at 1381. The Commission subsequently granted Qualcomm a transferable Auction Discount Voucher to be used in any spectrum licensing auction over a three-year period. *QUALCOMM, Inc.*, 16 F.C.C.R. 4042 (2000).

The D.C. Circuit is not alone in its view that the APA requires at least *some* kind of remedy for unlawful agency action. *See Andrx Pharm. Inc. v. Biovail Corp.*, 276 F.3d 1368, 1379 (Fed. Cir. 2002) (holding that a party that "prevails under its APA claim . . . is *entitled to a remedy* under the statute, which normally will be a vacatur of the agency's order") (emphasis added).

2. The Third Circuit's total denial of any auction-related remedy is also in conflict with the text and purposes of the APA. Refusing to provide any relief at all is the precise opposite of "set[ting] aside" unlawful agency action, 5 U.S.C. § 706(2)(A). The APA was specifically designed "to afford parties affected by administrative powers a means of knowing what their rights are, and how they may be protected," and to assure those affected parties "judicial review designed to afford *a remedy* for *every* legal wrong." 92 Cong. Rec. 2151 (1946), *reprinted in* Administrative Procedure Act, Legislative History, S. Doc. No. 79-248, at 304 (1946) (statement of Sen. Pat McCarran) (emphasis added). This guarantee of a judicial remedy, in the event of agency violation of a private right, is one of the "minimum basic essentials" set forth by the APA. *Id.*

Congress thus fully intended the APA to follow the basic American legal tenet that the law provides a remedy for every violation of a legal right. In the same year the APA was enacted, this Court reaffirmed the established principle that "where federally protected rights have been invaded, it has been the rule from the beginning that courts will be alert to adjust their remedies so as to grant the necessary relief." *Bell v. Hood*, 327 U.S. 678, 684 (1946). That fundamental principle found voice in this Court as long ago as *Marbury v. Madison*, 5 U.S. 137, 163 (1803): "The government of the United States has been emphatically termed a government of laws, and not of men. It will certainly cease to deserve this high appellation, if the laws furnish no remedy for the violation of a vested legal right." And this Court has consistently adhered to it ever since.

See, e.g., De Lima v. Bidwell, 182 U.S. 1, 176-77 (1901) ("If there be an admitted wrong, the courts will look far to supply an adequate remedy."); *Franklin v. Gwinnett Co. Pub. Sch.*, 503 U.S. 60, 66 (1992) ("From the earliest years of the Republic, the Court has recognized the power of the Judiciary to award appropriate remedies to redress injuries actionable in federal court . . . .").

B. Whether Courts Have Authority To Deny All Relief For APA Violations Is A Question Of Recurring Importance That Warrants This Court's Review.

The scope of any remedial discretion under Section 706 – like the availability of any discretion at all – is a recurring question that affects virtually every suit under the APA. The absence of guidance from this Court in this area has led to arbitrary differences in treatment and undermined the basic remedial purposes of the statute.

This case compellingly illustrates how, in the absence of guidance from this Court, the former rule that unlawful agency action must be set aside has in certain cases been replaced by nearly the opposite presumption that relief is to be severely limited or denied altogether if an agency violation is either "too minor to matter"[23] or, as here, "too big to fail." This "Goldilocks" approach led to the denial in this case of all relief with respect to two licensing auctions of

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[23] *See, e.g., La. Fed. Land Bank Ass'n v. Farm Credit Admin.*, 336 F.3d 1075, 1085 (D.C. Cir. 2003) (remand without vacatur employed where the agency's "only error was its failure to explain what seems to be a policy difference with the plaintiffs").

highly valuable, publicly-owned electromagnetic spectrum that were conducted pursuant to unlawful, seriously deficient rules.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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December 22, 2010

APPENDIX

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 08-2036

COUNCIL TREE COMMUNICATIONS, INC., BETHEL NATIVE CORPORATION, and THE MINORITY MEDIA AND TELECOMMUNICATIONS COUNCIL

Petitioners,

v.

FEDERAL COMMUNICATIONS COMMISSION and the UNITED STATES OF AMERICA,

Respondents.

On Petition for Review of Orders of the Federal Communications Commission

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DECIDED: August 24, 2010

Before FISHER, HARDIMAN and STAPLETON, Circuit Judges

COUNCIL TREE COMMUNICATIONS, INC.; BETHEL NATIVE CORPORATION; THE MINORITY MEDIA AND TELECOMMUNICATIONS COUNCIL, Petitioners v. FEDERAL COMMUNICATIONS COMMISSION; UNITED STATES OF AMERICA, Respondents, CTIA-WIRELESS Association and T-Mobile USA, Inc., Intervenor Respondents (Per Clerk Order of 4/28/08), CELLCO PARTNERSHIP d/b/a Verizon Wireless, Intervenor Respondent (Per Court Order of 6/30/08)

No. 08-2036

UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

HARDIMAN, *Circuit Judge.*

This dispute comes to us for the fourth time. At issue is a challenge to some of the rules that governed the participation of small wireless telephone service providers in auctions of electromagnetic spectrum conducted by the Federal Communications Commission (FCC or the Commission).

The FCC is authorized to grant licenses for the use of bands of the electromagnetic spectrum and has done so chiefly through auctions for defined geographic markets. Because the law requires the FCC to promote the participation of small businesses in the use of the spectrum, it has defined a class of

designated entities (DEs) which are eligible for bidding credits. These credits are added to the dollar amount of the DEs' bids, to make it easier for them to win spectrum licenses at auction.

The petitioners here are (1) Council Tree Communications, an investor in DEs; (2) Bethel Native Corporation, a small wireless carrier based in Alaska whose stock is owned by Alaskan natives; and (3) the Minority Media and Telecommunications Council (MMTC), a trade group representing minority-owned telecom companies. Petitioners seek review of multiple orders in an FCC rulemaking entitled *In re Implementation of the Commercial Spectrum Enhancement Act and Modernization of the Commission's Competitive Bidding Rules and Procedures*, WT Docket No. 05-211, in which the FCC changed the qualifications for DE status as well as the restitution that must be made by a licensee that loses DE status after taking advantage of bidding credits. Petitioners claim that these rules (1) were enacted without the notice and opportunity for comment required by the Administrative Procedure Act (APA), and (2) are arbitrary and capricious, in violation of the APA. Petitioners ask us to rescind the results of approximately $ 33 billion worth of auctions held under the challenged rules, and to order the FCC to conduct new auctions under new rules.

I.

A. Legal Background

Although the FCC possesses broad authority to auction licenses to use portions of the electromagnetic spectrum, it must promote "economic opportunity and competition . . . by avoiding excessive concentration of licenses and by disseminating licenses among a wide variety of applicants, including small businesses [and] rural telephone companies." 47 U.S.C. § 309(j)(3)(B). The FCC must also "ensure that small businesses [and] rural telephone companies . . . are given the opportunity to participate in the provision of spectrum-based services, and, for such purposes, consider the use of tax certificates, bidding preferences, and other procedures." *Id.* § 309(j)(4)(D).

Consistent with these statutory mandates, in conducting spectrum auctions the FCC offers bidding credits that increase the bids of small entities, in an amount measured as a percentage of the entities' initial bids. After a DE submits its bid, this credit is added to the bid for purposes of determining the winner of the auction. If the DE wins the auction, however, it will be required to pay only the amount of its initial bid, not the amount that includes the credit. The credits are available as follows: (1) a 15% credit for entities averaging annual gross revenues of $ 40 million or less over the last three years; (2) a 25% credit for entities averaging annual gross revenues of $ 15 million or less over the last three years; and (3) a 35% credit for entities averaging $ 3

million or less in average revenues over the last three years. 47 C.F.R. § 1.2110(f)(2)(i) to (iii). Although the FCC defines the term "designated entities" to mean "small businesses" generally, *see id.* § 1.2110(a), the term is relevant here only insofar as it refers to bidders who qualify for these credits.

The bidding-credit system could be abused by small companies willing to immediately monetize their bidding credits by selling their spectrum licenses at market prices, or by large companies taking advantage of credits through affiliates or puppet corporations that technically qualify as DEs. To prevent this, the FCC is required to seek the "avoidance of unjust enrichment through the methods employed to award" spectrum licenses, 47 U.S.C. § 309(j)(3)(C), and to establish "such . . . antitrafficking restrictions and payment schedules as may be necessary to prevent unjust enrichment as a result of the methods employed to issue licenses and permits." *Id.* § 309(j)(4)(E). In the rulemaking at issue here, the FCC adopted three regulations of this type.

First, to prevent subsidiaries or affiliates of large businesses from qualifying for DE credits, 47 C.F.R. § 1.2110(b)(1)(i) provides that:

> [t]he gross revenues of the applicant (or licensee), its affiliates, its controlling interests, the affiliates of its controlling interests, and the entities with which it has an attributable material relationship shall be attributed to the applicant (or licensee) and considered on a cumulative basis and aggregated for purposes of determining

> whether the applicant (or licensee) is eligible for status as a small business[.]

Insofar as it applies to an applicant's affiliates and controlling interests, and the affiliates of an applicant's controlling interests, this revenue attribution rule is long-standing and is not contested here. Instead, in the challenged rulemaking the FCC imposed revenue attribution for "entities with which [the applicant or licensee] has an attributable material relationship," and defined the phrase "attributable material relationship." That definition appears in 47 C.F.R. § 1.2110(b)(3)(iv)(B) and states:

> [a]n applicant or licensee has an attributable material relationship when it has one or more arrangements with any individual entity for the lease or resale (including under a wholesale agreement) of, on a cumulative basis, more than 25 percent of the spectrum capacity of any one of the applicant's or licensee's licenses.

The second challenged regulation is 47 C.F.R. § 1.2110(b)(3)(iv)(A), which was promulgated for the first time in the rulemaking at issue here and provides:

> [a]n applicant or licensee that would otherwise be eligible for designated entity benefits under this section and applicable service-specific rules shall be ineligible for such benefits if the applicant or licensee has an impermissible material relationship. An applicant or licensee has an impermissible material relationship when it has

> arrangements with one or more entities for the lease or resale (including under a wholesale agreement) of, on a cumulative basis, more than 50 percent of the spectrum capacity of any one of the applicant's or licensee's licenses.

Thus, unlike an "attributable material relationship," a business that has an *impermissible* material relationship is *ipso facto* disqualified from receiving bidding credits.

Third, the FCC has recognized that unjust enrichment will occur if recipients of bidding credits are permitted to promptly sell their spectrum rights to non-DEs at a premium, or to ally themselves with large entities in such a way as to lose their DE status. To prevent this, 47 C.F.R. § 1.2111(d)(1) states:

> [a] licensee that utilizes a bidding credit, and that during the initial term seeks to assign or transfer control of a license to an entity that does not meet the eligibility criteria for a bidding credit, will be required to reimburse the U.S. Government for the amount of the bidding credit, plus interest . . . as a condition of Commission approval of the assignment or transfer. . . . If, within the initial term of the license, a licensee that utilizes a bidding credit seeks to make any ownership change or to enter into a material relationship (see § 1.2110) that would result in the licensee losing eligibility for a bidding credit . . . the amount of the bidding credit . . . plus interest . . . must be paid to the U.S.

> Government as a condition of Commission approval of the assignment or transfer . . . .

If a DE licensee takes action that does not render it wholly ineligible for a bidding credit, but leaves it eligible only for a smaller credit than the one it used to acquire a license, the difference in value between the two credits must be repaid. *Id.*

This repayment obligation existed before the rulemaking challenged by Petitioners here. At issue in this petition is the length of time after a DE wins a license using a bidding credit that it is subject to the repayment requirement. Although the most effective method to prevent misuse of bidding credits would be to require that a DE winning a license with such credits both maintain its DE status and hold the license until it expired, it appears that the FCC has long applied a more lenient rule in order to permit DEs to participate in the secondary market for spectrum rights, and to allow DEs to attract investment capital that might be hard to obtain if there were no way for DEs to liquidate such a valuable asset. Accordingly, FCC regulations provide for a reduction in the repayment amount if the DE's offending action does not occur until an appreciable time after it won the license. In the rulemaking at issue here, the FCC extended the time period over which the repayment obligation applies. Before the rulemaking, 47 C.F.R. § 1.2111(d)(2)(i) provided that the required repayment dropped to 75% of the bidding credit value for license transfers or losses of DE status occurring up to two years after the auction, 50% of the credit for those occurring during the third year after the auction, 25% of the

credit during the fourth year, and zero after five years. *Id.* (effective through June 6, 2006). The instant rulemaking amended § 1.2111(d)(2)(i) to require full repayment of the credit if eligibility is lost in the first five years after the auction, 75% repayment if eligibility is lost in the sixth or seventh year, 50% if eligibility is lost in the eighth or ninth year, 25% in the tenth year, and eliminated the penalty only after ten years.

B. The Rulemaking Proceeding

1. The Further Notice of Proposed Rulemaking

On February 3, 2006, the FCC issued a Further Notice of Proposed Rulemaking *In re Implementation of the Commercial Spectrum Enhancement Act and Modernization of the Commission's Competitive Bidding Rules and Procedures*, 21 F.C.C.R. 1753 (2006) (hereinafter FNPR). The FNPR was a response to an *ex parte* letter from Council Tree Communications (Council Tree), the lead petitioner here. In the FNPR, the FCC agreed with Council Tree's view "that the Commission's current rules do not adequately prevent large corporations from structuring relationships in a manner that allows them to gain access to benefits reserved for small businesses." *Id.* at 1759-60. Therefore, the FNPR sought "comment on the elements of a proposal raised by Council Tree . . . that seeks to prohibit the award of bidding credits or other small business benefits to entities that have what Council Tree refers to as a 'material relationship' with a 'large in-region incumbent wireless service provider.'" *Id.* at 1754 (footnotes

omitted). The FCC "tentatively conclude[d]" that such regulations were appropriate, *id.* at 1757, and "s[ought] comment on how [it] should define the elements of such a restriction," *id.* at 1755, as well as "on whether [it] should [also] restrict the award of designated entity benefits where an otherwise qualified designated entity has a 'material relationship' with a large entity that has a significant interest in communications services," *id.*

Throughout the FNPR, the FCC reiterated these requests for comments in similar or identical terms. *See id., passim.* It also solicited comments in more specific terms on possible variations on each of the elements proposed by Council Tree. With respect to the definition of "material relationship," the FCC inquired whether its then-current rules requiring attribution of the revenues of an applicant's controlling interests and affiliates were sufficient to prevent improper influence by large businesses over small bidders. *Id.* at 1760-61. The FCC asked whether those attribution rules, or any new definition of "material relationship," should vary according to whether they were applied to "large, in-region, incumbent wireless service providers" or "entit[ies] with significant interests in communications services." *Id.* at 1760. Of particular note here, the FCC

> s[ought] comment on what, if any, standard should be used to determine whether a spectrum leasing arrangement is a 'material relationship' for the purpose of any additional restriction on the availability of designated entity benefits that we might adopt. We also

> seek comment on whether other arrangements should be taken into account. If so, what arrangements should we consider?

Id. at 1761.

With respect to the definition of "large, in-region, incumbent wireless service provider," the FCC sought comment on how much geographic overlap between the incumbent's and DE's service areas should be required for the "in-region" criterion to be met, *id.* at 1759, 1762, and whether gross revenues were the appropriate metric for determining whether the incumbent was "large," and, if so, what the proper cutoff would be. *Id.* at 1759, 1761-62. With respect to the phrase "entity with significant interests in communications services," the FCC inquired how "large" status should be determined, *id.* at 1761-62, whether an "in-region" geographical element should also apply, *id.* at 1762, and how broadly the phrase "significant interests in communications services" should be defined, and what kinds of entities it should encompass, *id.* at 1762-63.

The FNPR also sought comment

> on whether, if we adopt a new restriction on the award of bidding credits to designated entities, we should adopt revisions to our unjust enrichment rules such as those proposed by Council Tree, or in some other manner. . . . If we require reimbursement by licensees that, either through a change of 'material relationships' or assignment or transfer of control of the license, lose their

> eligibility for a bidding credit pursuant to any eligibility restriction that we might adopt, over what portion of the license term should such unjust enrichment provisions apply?

Id. at 1763. The FCC also explicitly requested comment on whether the proposed restrictions risked unduly limiting DEs' ability to raise capital. *Id.* at 1761.

Finally, the FCC confirmed in the FNPR that it expected "to complete this proceeding in time so that any modifications to our rules resulting from this proceeding will apply to the upcoming auction of licenses for Advanced Wireless Services ('AWS'), which currently is scheduled to begin June 29, 2006," which was less than four months after the release of the FNPR. *Id.* at 1755, 1763. This auction – known as "Auction 66" – was the largest spectrum auction in several years. To achieve this goal, the comment period on the FNPR ran for only 14 days after its publication in the Federal Register, and the reply comment period lasted only one week thereafter. *Id.* at 1753.

2. Comments on the FNPR

Despite the brief time frame, a number of comments on the FNPR were submitted. Most commenters supported some changes along the lines suggested by the FNPR. A representative comment in this regard came from the Department of Justice, which reported that it had

> found contractual or other arrangements between DEs and large wireless carriers that

> created such close ties between the two that the DEs could not be considered to be truly independent competitive actors; in some of these instances, the DE affiliated with a large wireless carrier had not launched commercial services to end-user customers or other wireless carriers but only provided roaming services to its large affiliate.

J.A. 1052-53. In light of this finding, the DOJ recommended that such a relationship disqualify the DE, but suggested that lower-level relationships, such as "arm's-length negotiated agreements for roaming or brand licensing and support," *id.* at 1054, would not necessarily be problematic. In sum, the DOJ maintained that "[a] relationship where the large enterprise dominates the DE is troubling as it suggests that the DE is not within the class of entities (i.e., small businesses) that the FCC's rules are designed to benefit." *Id.*

Several comments addressed the application of the proposed rules to spectrum leases by DEs to non-DEs. Council Tree agreed that the suspect class of arrangements should include leasing arrangements, J.A. 439, arguing that such "agreements . . . convey a level of influence over the operations of the designated entity that is inappropriate in the hands of a dominant national wireless service provider," *id.* at 439-40. The NTCH, Inc. proposed that DEs should be able to lease spectrum freely, so long as substantial portions of spectrum in the same geographic area remained in use by DEs. J.A. 663-64. Wirefree Partners argued against any further

restrictions on leasing by DEs, J.A. 759-60, but Council Tree disagreed, J.A. 873-74.

Several commenters also argued that the proposed categories of "large, in-region, incumbent wireless service providers" or "large entities with significant interests in communications services" were too narrow. These commenters argued repeatedly that the statutory objective of assisting small businesses would be frustrated by a bidder's material relationship with a large business of *any* kind, regardless of whether the large business was involved in the communications industry. *See* Comments of CTIA – The Wireless Association, J.A. 510, 518 ("the *Notice* makes no attempt to justify a distinction between large incumbent carriers and any other class of non-attributable investor," such as AOL, Google, or Microsoft, but the problems arising from large investors' dominance of DEs "would presumably run to all potential investors, not just large carrier partners"); Comments of Dobson Comm'ns Corp., J.A. 526 (urging the FCC to apply any changes to "any large, well-funded investor with a strategic interest in the use of the spectrum"); Comments of T-Mobile USA, Inc., J.A. 697 ("[t]here does not appear to be a justification for permitting Microsoft or Wal-Mart to participate in a DE joint venture while precluding T-Mobile from doing so."); *see also* Comments of Verizon Wireless, J.A. 745; Comments of Wirefree Partners III, LLC, J.A. 760; Reply Comments of T-Mobile USA, Inc., J.A. 812; Reply Comments of Cingular Wireless LLC, J.A. 833-34.

3. The Second Report and Order and Second Further Notice of Proposed Rulemaking

After receipt of the aforementioned comments, on April 25, 2006, the FCC adopted and released its Second Report and Order and Second Further Notice of Proposed Rulemaking (Second R&O), 21 F.C.C.R. 4753 (2006).[1] Therein, the FCC stated its "particular intention . . . to ensure that entities ineligible for designated entity incentives cannot circumvent our rules by obtaining those benefits indirectly, through their relationships with eligible entities." *Id.* at 4754. The FCC acknowledged that

> [t]he challenge for the Commission in carrying out Congress's plan has always been to find a reasonable balance between the competing goals of, first, providing designated entities with reasonable flexibility in being able to obtain needed financing from investors and, second, ensuring that the rules effectively prevent entities ineligible for designated entity benefits from circumventing the intent of the rules by obtaining those benefits indirectly, through their investments in qualified businesses.

Id. at 4756 (footnote omitted). To this end, the FCC "agree[d] with commenters that certain agreements have the potential to significantly influence a designated entity licensee's decisions regarding its provision of service and, therefore, also have the potential to be abused, absent the appropriate

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[1] The first Report and Order is not directly relevant here.

safeguards." *Id.* at 4762. In an attempt to create such safeguards, and as we described herein, the Second R&O established revenue attribution for "attributable material relationships," defined as the lease of more than 25% of the DE's spectrum capacity by any single lessee, and mandated the loss of DE status by any licensee that acquires an "impermissible material relationship," by leasing an aggregate of more than 50% of its spectrum capacity. *Id.* at 4763-64.

Notably, neither the 25% rule nor the 50% rule applied only to relationships with large entities. This, said the Second R&O, was because the FCC had

> conclude[d] that certain agreements, by their very nature, are generally inconsistent with an applicant's or licensee's ability to achieve or maintain designated entity eligibility because they are inconsistent with Congress's legislative intent. In this regard, where an agreement concerns the actual use of the designated entity's spectrum capacity, it is the agreement, as opposed to the party with whom it is entered into, that causes the relationship to be ripe for abuse and creates the potential for the relationship to impede a designated entity's ability to become a facilities-based provider, as intended by Congress.

Id. at 4762.

The legislative intent referenced is that behind 47 U.S.C. § 309(j)(4)(C), the authorization for the

FCC's promulgation of antitrafficking and anti-unjust enrichment provisions. The House of Representatives Budget Committee's report on this provision explicitly contemplated its use in connection with the promotion of small-business licenses, and stated that "[t]he Committee anticipates that the Commission will use this authority to deter speculation and participation in the licensing process by those who have no intention of offering service to the public." H.R. Rep. No. 103-111, at 257-58, *reprinted in* 1993 U.S.C.C.A.N. 378, 584-85. The Second R&O reiterated its reliance on this congressional intent several times. 21 F.C.C.R. at 4755, 4760, 4762-64, 4766.

The Second R&O also extended the bidding-credit-repayment schedule to 10 years. The extended obligation applies "if a designated entity loses its eligibility for a bidding credit for any reason, including but not limited to[] entering into an 'impermissible material relationship' or an 'attributable material relationship.'" *Id.* at 4766. The FCC again stated that "[b]y extending the unjust enrichment period to ten years, we increase the probability that the designated entity will develop to be a competitive facilities-based service provider." *Id.*

The Second R&O also included a Second Further Notice of Proposed Rulemaking, which sought additional comment on the elements of Council Tree's initial proposal, namely, whether the FCC should impose further restrictions on grants of DE status to applicants having other sorts of "material relationships" with large in-region incumbent

wireless providers. *Id.* at 4773-74 (seeking comment on the definition of "large" and whether relationships with non-wireless businesses should also be regulated); 4776-78 (seeking comment on propriety and definition of "in-region" criterion); 4779-84 (same, on definition of "material relationship"). The FCC noted its "concern[] that additional types of relationships could . . . allow[] an ineligible entity the ability to gain undue advantages in the communications marketplace through the benefits offered to a designated entity applicant," and asked, "[a]re the new rules we adopt today sufficient to safeguard against many of these concerns?" *Id.* at 4780.

The Commission further stated, however, that

> [w]e generally do not have the same concerns regarding relationships between designated entity applicants and those who do not have interests in spectrum capacity or the provision of service, such as financial institutions or venture capital firms, provided that such entities do not have a controlling interest relationship with the applicant.

Id. This, said the FCC, was because cross-industry investments did not present the investor an "opportunity for it to bundle existing communications services with a strategic wireless partner, and there is less potential for those entities to exert undue influence over a designated entity licensee's decision making regarding its service provision or the use of its licensed spectrum." *Id.*

4. Response to the Second R&O

The new rules promulgated in the Second R&O provoked criticism from some DEs and their investors. Several petitions for reconsideration were filed with the FCC, including one by the Petitioners here. Two of Petitioners' arguments for reconsideration before the FCC are relevant here. First, Petitioners maintained that "[n]one of the new rules is limited to arrangements involving large, in-region incumbent wireless service providers as contemplated in the *Further Notice of Proposed Rule Making*." Pet. for Exp. Reconsid'n, J.A. 1281. Second, Petitioners argued that the 10-year credit-repayment schedule "eviscerat[es] a designated entity's access to capital because lenders and investors who are being asked to back untested new entrants want to see that the designated entity has a clear path to exit if the business is not succeeding," *id.* at 1281-82, and that the FCC had failed to take this into account in setting the new rules.

Both of Petitioners' objections were supported by the views of a number of other commenters, most of whom contacted the FCC for the first time in response to the Second R&O. Catalyst Investors, LLC, which had provided capital for several DEs in the past and was planning to do so in connection with Auction 66, stated:

> both the equity and the debt markets will not be comfortable with the '10 Year Hold Rule,' as it is outside the normal hold periods for most sources of capital. Due to a lack of reasonable notice in the proceeding, the rule

> came as a surprise and was not the subject of any meaningful public input. Had such input been received, we strongly believe the Commission would have realized that the 10 year period is just too long.

Id. at 1243; *cf. Ex Parte* Presentation of The Eezinet Corp., et al., S.J.A. 91 (same arguments, by a group of DE financiers and DEs); Notice of *Ex Parte* Presentation of Cook Inlet Region, Inc., J.A.1487 (small carrier allied with T-Mobile commenting that "[n]o significant investor will be willing to risk its return on investment over a ten year horizon"); Letter from the Nat'l Telecomm'ns Coop. Ass'n, J.A. 1508-09 (industry group representing rural telecoms, complaining of a lack of public notice and the short time between the promulgation of the rules and Auction 66); *Ex Parte* Letter from Coral Wireless Licenses, LLC, et al., J.A. 1547-48 (another group of small businesses and their investors, commenting that "[a] business transaction where there is no clear path to liquidity for 10 years is a very unattractive investment for the financial institutions and venture capital firms that traditionally have supported wireless start-up ventures," and that they "did not understand from the *Further Notice* that changes of this nature were under consideration by the Commission or they would have commented on this issue"); Notice of Oral *Ex Parte* Presentation of Doyon, Ltd., J.A. 1550 (investor in small telecoms commenting that "the new ten year unjust enrichment schedule . . . makes it more difficult for designated entities to secure financing and find strategic partners because it is less likely that they can easily exit the business in the event of significant

changes in the industry"); Letter from Royal Street Comm'ns, LLC, J.A. 1557 ("[A] transaction where there is no clear path to liquidity, without penalty, for 10 years is a very unattractive investment for the types of financial institutions and venture capital firms that traditionally have supported wireless start-up ventures.").

Royal Street Communications LLC, a DE engaged in wireless wholesaling, objected that the new rules impacted arrangements by DEs with other small entities, as well as large ones. Letter from Royal Street Comm'ns, LLC, J.A. 1557. Royal Street claimed the new rules placed restrictions on wireless wholesaling

> without affording . . . DEs notice and the opportunity to comment. . . . [T]hese restrictions will also contribute to investor and financier reluctance to back wireless licenses that are effectively limited to a retail business model, a model decidedly more expensive and administratively burdensome. The Order's restrictions ignore the fact that wholesale services are a wireless product increasingly in demand . . . which can add to the competitive options in the wireless marketplace.

Id. at 1558. The Rural Telecommunications Group., Inc., also contended that "[t]he new material relationship rules are overbroad and unduly restrictive," because, "current DE licensees will be unable to . . . lease existing spectrum . . . to another DE without becoming ineligible for DE benefits in

the AWS auction." *Ex Parte* Letter from the Rural Telecomm'ns Group, Inc., J.A. 1542.

5. The Order on Reconsideration of the Second R&O

On June 2, 2006, the FCC released an *Order on Reconsideration of the Second Report and Order*, 21 F.C.C.R. 6703 (hereinafter the Order on Reconsideration).[2] Although it addressed the issues raised in Petitioners' petition for reconsideration, the Order on Reconsideration did not formally grant or deny the petition, but instead was raised by the FCC "on [its] own motion." *Id.* at 6703.

Defending the regulations against the charge that they would unduly restrict DEs to a retail-only business model, the FCC restated and clarified its position that active use of a spectrum license was required to maintain DE status:

> [s]ection 309(j)(4)(D) directs the Commission to issue regulations to 'ensure' that designated entities 'are given the opportunity to participate in the provision of spectrum-based services.' We believe that the word 'participate' in this directive contemplates significant involvement in the provision of services to the public, not merely passive ownership of a license to spectrum used by others to provide service.

Id. at 6705 n.8 (internal citation omitted). In response to Petitioners' arguments that the material-

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[2] Many of the comments just described were submitted after the Order on Reconsideration was released.

relationship rules had not been properly noticed, the FCC noted that the FNPR had asked whether DE relationships with entities other than large in-region incumbents or entities with interests in communications services should be restricted as well. *Id.* at 6711. The FCC also noted that the FNPR had included an open-ended inquiry into what types of relationships should be regulated, and had specifically contemplated the inclusion of lease arrangements among those relationships. *Id.* The FCC concluded that the changes embodied in the final rulemaking were all contained in, or logical outgrowths of, the proposal in the FNPR. *Id.* at 6712.

With respect to the 10-year credit-repayment period, the FCC stated that its decision to apply the new schedule to the preexisting DE qualifications as well as the new ones was also within the scope of its original proposal. The Commission stated that "had we only revised the five-year unjust enrichment schedule for certain types of transactions but not for others, we would have risked creating an illogical scheme that would have created an incentive for designated entities to prioritize certain types of transactions over others." *Id.* at 6716. Turning to the contentions that the 10-year rule would cause DEs' funding to dry up, the FCC was

> not convinced that three to seven years is a reasonable timeframe for investors to expect to recover their capital investments in facilities to provide spectrum-based services. In a recently concluded proceeding addressing the leasing of Educational Broadcast Service

> spectrum, a broad cross-section of commenters, including a private equity investment firm, submitted evidence that insufficient capital would flow to businesses that want to develop that spectrum if the length of spectrum lease terms was limited to fifteen years. These parties argued that lessees needed access to the spectrum for thirty years or more in order to provide the necessary certainty to justify capital investment in the band. The Commission was 'persuaded by [this argument].'

Id. at 6717 (footnotes omitted). Finally, the FCC concluded that even if the new rules did hamper DE capitalization somewhat, this was an acceptable balancing of the statutory goals of encouraging DE participation on the one hand while ensuring that DEs provide "facilities-based service to the public." *Id.* at 6718.

C. The First Petition for Review and the Mandamus Petition

On June 7, 2006 – two days before the Order on Reconsideration was published in the *Federal Register* – Petitioners filed their first petition in this Court for review of the Second R&O, the Order on Reconsideration, and the public notice that had announced the start dates for Auction 66, *Auction of Advanced Wireless Services Licenses Rescheduled for August 9, 2006*, 21 F.C.C.R. 5598 (2006) (hereinafter the Public Notice). Petitioners moved for an emergency stay of Auction 66, which was denied by a motions panel of this Court on June 29,

2006. After briefing and argument on the merits, in September 2007 we held that we lacked jurisdiction to entertain the petition because it was incurably premature. *Council Tree Comm'ns v. FCC*, 503 F.3d 284, 293 (3d Cir. 2007). We noted that by statute, petitions for judicial review of FCC actions can be filed only in the 60 days following "the entry of a final order." *Id.* at 287 (quoting 28 U.S.C. § 2344, citing 47 U.S.C. § 402(a)). We also noted that because the FCC had not formally disposed of Petitioners' motion for reconsideration of the Second R&O, that order was non-final and therefore the petition for its review was premature. *Id.* We further concluded that the Order on Reconsideration was "entered," within the meaning of the statute, only when it was published in the Federal Register, and that we had no jurisdiction to entertain a petition filed *before* this publication. *Id.* at 291-93.

After we issued our opinion, Petitioners sought a writ of mandamus ordering the FCC to act on the petition for reconsideration, to facilitate jurisdiction in this Court. Although we declined to issue a writ of mandamus, on February 15, 2008 we directed the FCC to inform us when it would grant or deny the petition. On March 26, 2008 the FCC formally denied the petition in a brief Second Order on Reconsideration, noting that "we already decided the merits of the Petition in the *Order on Reconsideration*." 23 F.C.C.R. 5425, 5426. Within 60 days of that denial, on April 8, 2008, Petitioners filed this petition for review of the Second R&O,

Order on Reconsideration, Second Order on Reconsideration, and the Public Notice.[3]

D. The Results of Auctions 66 and 73

While Petitioners' first petition for review was pending in 2006, the FCC conducted Auction 66 subject to the rules challenged here. The deadline for applications to bid fell on June 19, 2006; DEs accounted for 166 of 252 applications and 100 out of 168 qualified bidders permitted to participate. Bidding commenced on August 9, 2006, and the auction generated nearly $ 14 billion in winning bids. DEs were 57 of the 104 winning bidders, winning 20% of the individual licenses auctioned. Measured in terms of dollar value, however, DEs won only 4% of the spectrum licenses, although two DEs were among the top ten winners in terms of dollar amounts. By comparison, in auctions held prior to

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[3] It does not appear that the FCC has formally acted on the petitions for reconsideration of the Second R&O that were filed by parties other than Petitioners. This is no barrier to our jurisdiction, however. In *Council Tree* we held only that "[a]n agency order is non-final as to an aggrieved party whose petition for reconsideration remains pending before the agency." 503 F.3d at 287. And indeed, "[i]t is well established . . . that when two parties are adversely affected by an agency's action, one can petition for reconsideration before the agency at the same time that the other seeks judicial redetermination." *W. Penn Power Co. v. EPA*, 860 F.2d 581, 586 (3d Cir. 1988) (citing *Am. Farm Lines v. Black Ball Freight Serv.*, 397 U.S. 532, 541, 90 S. Ct. 1288, 25 L. Ed. 2d 547 (1970)).

the new rules, DEs had won, on average, 70% of the licenses by dollar value.[4]

In late 2007 and early 2008, during and just after the pendency before the FCC of Petitioners' petition for reconsideration, the FCC held another, even larger spectrum auction, known as "Auction 73." Auction 73 generated about $ 19 billion in winning bids, and was also conducted under the rules challenged here. In Auction 73, DEs comprised 119 of 214 qualified bidders and 56 of 101 winners, and won 35% of the individual licenses. They won only 2.6% of the total dollar value of the licenses, however.

II.

Petitioners now petition for review of the Second R&O, the two reconsideration orders, and the Public Notice. Several interested parties, many of them winners at Auctions 66 and 73, have intervened or filed *amicus curiae* briefs in support of the FCC. We have jurisdiction to review the FCC's final orders pursuant to 28 U.S.C. § 2342(1) and 47 U.S.C. § 402(a).[5]

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[4] These data must be considered in light of the absence from Auctions 66 and 73 of the set-asides by which, in prior auctions, only DEs had been permitted to purchase certain spectrum blocks. Also, the purpose of the instant rulemaking from its inception was to disqualify sham DEs, which would be expected to reduce the number of qualifying DEs.

[5] The FCC, along with its intervenors and *amici*, attacks our jurisdiction to review the Public Notice. Because this dispute bears on the remedy for any defects in the rules under review,

Petitioners claim the new regulations are invalid for several reasons. First, they claim that because the new rules were not sufficiently foreshadowed by the FNPR, they were adopted without the public notice and opportunity for comment required by the Administrative Procedure Act.[6] Petitioners also argue that the new rules are arbitrary and capricious, because the FCC made no findings as to their impact on the ability of small businesses to procure financing, and because they ignore the viability of wholesaling as a facilities-based business model for DEs.[7] These challenges differ slightly with

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rather than on the validity of the rules themselves, we consider it after our analysis of the latter issue. *See infra*, Part III.

[6] Petitioners also argue that the rulemaking violated the Regulatory Flexibility Act (RFA), as codified at 5 U.S.C. §§ 603-04. We need not address this theory of recovery further because, on the facts of this case, we regard it as duplicative of the APA notice-and-comment claim: to the extent that the FCC failed to give notice of the new rules for RFA purposes, it also gave inadequate notice for APA purposes, necessitating a remand on the latter basis alone. On remand, of course, the FCC must comply with all RFA requirements.

[7] Petitioners make another subsidiary argument: they claim that the new rules present such obstacles to small businesses' participation in FCC auctions that they violate 47 U.S.C. § 309(j)(3)(B)'s requirement that the Commission "seek to promote" the objective of "economic opportunity and competition . . . by avoiding excessive concentration of licenses and by disseminating licenses among a wide variety of applicants, including small businesses [and] rural telephone companies." But the statute also requires the FCC to promote the development and deployment of new technologies and services, *id.* § 309(j)(3)(A), recover a portion of the value of the spectrum and prevent unjust enrichment, *id.* § 309(j)(3)(C), and ensure "efficient and intensive use" of the spectrum, *id.*

respect to the three provisions challenged here: (1) the 25% attribution rule, (2) the 50% impermissible-relationship rule, and (3) the 10-year credit-repayment schedule.

A. Legal Standard: The Administrative Procedure Act

1. The Notice-and-Comment Requirement

Under the APA, federal agencies must publish "either the terms or substance of the proposed rule or a description of the subjects and issues involved." 5 U.S.C. § 553(b)(3). The APA further requires that "[a]fter notice required by this section, the agency shall give interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments with or without opportunity for oral presentation." *Id.* § 553(c). In interpreting these provisions, courts have held that if the substance of an agency's final rule strays too far from the description contained in the initial notice, the agency may have deprived interested persons of their statutory right to an opportunity to participate in the rulemaking. *E.g., Long Island Care at Home, Ltd. v. Coke*, 551 U.S. 158, 174, 127 S. Ct. 2339, 168 L. Ed. 2d 54 (2007) ("The Courts of Appeals have generally interpreted this to mean that the final rule the agency adopts must be 'a logical outgrowth' of the

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§ 309(j)(3)(D). Given the general agreement that the DE program can be abused, as well as the continuing participation by DEs in auctions held under the new rules, we cannot conclude that the FCC has failed to promote small-business participation at all.

rule proposed. The object, in short, is one of fair notice.") (quoting *Nat'l Black Media Coal. v. FCC*, 791 F.2d 1016, 1022 (2d Cir. 1986); citing *United Steelworkers, AFL-CIO-CLC v. Marshall*, 647 F.2d 1189, 1221, 208 U.S. App. D.C. 60 (D.C. Cir. 1980) and *S. Terminal Corp. v. EPA*, 504 F.2d 646, 659 (1st Cir. 1974)). The principles governing judicial review of notice-and-comment rulemaking are well established. As the Court of Appeals for the District of Columbia Circuit has put it:

> [n]otice requirements are designed (1) to ensure that agency regulations are tested via exposure to diverse public comment, (2) to ensure fairness to affected parties, and (3) to give affected parties an opportunity to develop evidence in the record to support their objections to the rule and thereby enhance the quality of judicial review. While an agency may promulgate final rules that differ from the proposed rule, a final rule is a logical outgrowth of a proposed rule only if interested parties should have anticipated that the change was possible, and thus reasonably should have filed their comments on the subject during the notice-and-comment period[.] The 'logical outgrowth' doctrine does not extend to a final rule that is a brand new rule, since something is not a logical outgrowth of nothing, nor does it apply where interested parties would have had to divine the Agency's unspoken thoughts, because the final rule was surprisingly distant from the proposed rule[.]

Int'l Union, United Mine Workers v. Mine Safety & Health Admin., 407 F.3d 1250, 1259-60, 366 U.S. App. D.C. 54 (D.C. Cir. 2005) (internal quotation marks, brackets, and citations omitted).

2. The Arbitrary-and-Capricious Standard

Another portion of the APA, codified at 5 U.S.C. § 706(2), provides that on a petition for review of an agency action,

> the reviewing court shall decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of an agency action. The reviewing court shall—
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> . . .
>
> (2) hold unlawful and set aside agency action, findings, and conclusions found to be—
>
> (A) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law . . . .

The Supreme Court has stated that

> [t]he scope of review under the 'arbitrary and capricious' standard is narrow and a court is not to substitute its judgment for that of the agency. Nevertheless, the agency must examine the relevant data and articulate a satisfactory explanation for its action including a rational connection between the facts found and the choice made. In

> reviewing that explanation, we must consider whether the decision was based on a consideration of the relevant factors and whether there has been a clear error of judgment. Normally, an agency rule would be arbitrary and capricious if the agency has relied on factors which Congress has not intended it to consider, entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise. The reviewing court should not attempt itself to make up for such deficiencies: [w]e may not supply a reasoned basis for the agency's action that the agency itself has not given. We will, however, uphold a decision of less than ideal clarity if the agency's path may reasonably be discerned.

Motor Vehicle Mfrs. Ass'n of U.S. v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 43, 103 S. Ct. 2856, 77 L. Ed. 2d 443 (1983) (internal quotation marks and citations omitted). In situations where "an agency has engaged in line-drawing determinations[,]. . . our review is necessarily deferential to agency expertise," but the agency's actions must still "not be 'patently unreasonable' or run counter to the evidence before the agency." *Prometheus Radio Project v. FCC*, 373 F.3d. 372, 390 (3d Cir. 2004) (citations omitted).

B. Validity of the 25% Attribution Rule

1. Notice and Comment Compliance

With the foregoing legal principles in mind, we now consider the rulemaking at issue, beginning with the 25% attributable relationship rule. As noted previously, 47 C.F.R. § 1.2110(b)(1)(i) and (b)(3)(iv)(B) provide that, if a DE leases or resells (including at wholesale) more than 25% of its spectrum capacity to any single lessee or purchaser, it must add that lessee's or purchaser's revenues to its own to determine its continued eligibility for DE credits. Petitioners claim this rule was not adequately noticed in the FNPR, because the FNPR was focused on avoiding domination of DEs by large communications companies, and made no mention of placing limits on all leases to any lessee. We disagree.

As we described previously, the FNPR explicitly sought comment on whether the FCC's definition of restricted "material relationships" should include spectrum leasing arrangements, and also asked whether other relationships should be considered. Moreover, the FNPR solicited comment on how large an entity must be before its relationships with DEs become problematic. In our view, by limiting the permissible combined size of a DE and entities to which it leases one-quarter or more of its spectrum, the final rule squarely addresses these concerns. It is true that, by adopting the attribution approach, the rule focuses not on the size of the related entity, but rather on the *combined* size of the DE itself and the related entity. But we regard this as a logical

outgrowth of the original rule's focus on ensuring that the Commission's "small business provisions . . . be available only to bona fide small businesses." FNPR, 21 F.C.C.R. at 1757, 1767. Therefore, we find no defect of notice in the FCC's enactment of the 25% attribution rule.

2. Arbitrary and Capricious Review

Petitioners also argue that the 25% rule is arbitrary and capricious, because the FCC made no findings on the impact it would have on the ability of DEs to procure financing. According to Petitioners, the FCC could not have articulated a rational connection between the conclusion reached and the facts found, because it found no facts at all.

This question is a close one. Petitioners are correct that the FCC made few factual findings on the impact of the new rules on DE financing. The Commission did observe that "a growing number" of relationships required regulation in order to prevent unjust enrichment. Second R&O, 21 F.C.C.R. at 4762. It also relied on its "experience in administering the designated entity program" in determining that further rules were required. *Id.* at 4762, 4763. The Second R&O acknowledged the concerns of several commenters about the impact any new rules would have on their capitalization arrangements, *see id.* at 4761 & n.65, but the only statement in the Second R&O even approaching a finding in this regard was a recital that the new rules would protect the ability of DEs to raise funds, *id.* at 4764 ("we . . . ensure that [DEs will retain]

flexibility to engage in agreements that are intended to provide [them] with access to valuable capital").

On the other hand, the record reflects the FCC's cognizance of the capitalization issue, and that it engaged in a line-drawing exercise in an attempt to prevent unjust enrichment without unduly impairing DEs' capital access. In the FNPR, the FCC explicitly "recognize[d] that we must strike a delicate balance between encouraging the participation of [genuinely] small businesses . . . and ensuring that those small businesses who do participate . . . have sufficient capital and flexibility," FNPR, 21 F.C.C.R. 1757, and solicited comment on this issue, *id.* at 1767.

Moreover, although the FCC solicited comments from the DE and investment communities with respect to the effects of a rule change on DEs' capitalization, this sort of prediction is inherently speculative. In this regard, we find this case similar to *FCC v. National Citizens Committee for Broadcasting*, 436 U.S. 775, 98 S. Ct. 2096, 56 L. Ed. 2d 697 (1978) (hereinafter *NCCB*). In *NCCB*, the Supreme Court reviewed an FCC rule prohibiting common ownership of newspapers and TV stations where only one of each existed in the relevant geographic market. *Id.* at 796-97. Although the Court found it "inconclusive" whether the rule would actually achieve its stated goal of increasing the diversity of broadcast programming, *id.*, it declared that "[i]n these circumstances, the Commission was entitled to rely on its judgment, based on experience, that it is unrealistic to expect true diversity from a commonly owned station-newspaper combination. The divergency of their viewpoints cannot be

expected to be the same as if they were antagonistically run." *Id.* at 797 (internal quotation marks and citation omitted).

Also at issue in *NCCB* was the FCC's decision not to give the new rules retroactive application with respect to some markets. This was based on the FCC's concern that retroactive application might result in a loss of local ownership of some broadcast stations, require the replacement of incumbent station owners who had performed exceptionally well, or force existing owners to sell their stations at a loss and thus discourage future investment in quality programming. *Id.* at 813. The Court of Appeals found this decision arbitrary, because the record did not indicate the extent to which these problems would actually arise if the divestiture requirement were applied across the board. The Supreme Court reversed, explaining that

> to the extent that factual determinations were involved in the Commission's decision to "grandfather" most existing combinations, they were primarily of a judgmental or predictive nature – *e.g.*, whether a divestiture requirement would result in trading of stations with out-of-town owners; whether new owners would perform as well as existing crossowners, either in the short run or in the long run; whether losses to existing owners would result from forced sales; whether such losses would discourage future investment in quality programming; and whether new owners would have sufficient working capital to finance local programming. In such

> circumstances complete factual support in the record for the Commission's judgment or prediction is not possible or required; a forecast of the direction in which future public interest lies necessarily involves deductions based on the expert knowledge of the agency.

Id. (internal quotation marks and citation omitted).

Like in *NCCB*, here the FCC's attempts at factfinding relevant to the impact of its proposed rules on DE financing were thin, perhaps because of its haste in promulgating rules before Auction 66. As a result, the Commission's consideration of the matter is neither as clear nor as thorough as would be ideal. Nonetheless, in light of the great deference to agency experience that we owe "where the issues involve 'elusive' and 'not easily defined' areas" such as this, *Prometheus Radio Project*, 373 F.3d. at 390 (quoting *Sinclair Broad. Group v. FCC*, 284 F.3d 148, 159, 350 U.S. App. D.C. 313 (D.C. Cir. 2002)), we conclude that the FCC offered enough consideration of DE capitalization to pass the arbitrary and capricious threshold with respect to the 25% attribution rule.

For these reasons, we will deny the petition insofar as it challenges the 25% attribution rule, and uphold the validity of 47 C.F.R. § 1.2110(b)(1)(i) and (b)(3)(iv)(B).

C. The 50% Impermissible-Relationship Rule

1. Notice and Comment Compliance

We next consider 47 C.F.R. § 1.2110(b)(3)(iv)(A), which makes license applicants or holders ineligible for DE benefits if they lease or resell (including at wholesale) more than 50% of their spectrum capacity. Aside from the difference in percentages, this rule diverges from the 25% attribution rule in two crucial ways. First, the 50% impermissible-relationship rule considers the *aggregate* portion of spectrum capacity that a licensee has leased or resold, rather than the portion of capacity leased to an individual lessee as does the 25% rule. Second, the 50% rule is a *per se* disqualification from DE status, rather than a mere attribution requirement. These two characteristics are the essential elements of the rule.

The aggregation element of the 50% rule was not mentioned in the FNPR, nor, in our view, can it be regarded as a logical outgrowth of the concerns addressed therein. The FNPR was focused on ensuring that a DE remains a genuinely small business, rather than a front entity controlled or heavily influenced by a large entity that is not eligible for bidding credits. As we noted, the 25% attribution rule addresses this concern directly by limiting the allowable combined size of groups of related license holders or users which include DEs. By contrast, because the 50% rule involves aggregation of all of a DE's lease or resale agreements, it would deny DE status to a small company that leases or resells 5.1% of its spectrum

capacity to each of ten other companies, regardless of how small those lessees or buyers, or all of them combined, might be. It is true, of course, that this aggregation rule also strips DE status from small businesses that lease or resell almost all of their spectrum to several large carriers, in chunks of just under 25%. But we find no basis in the record to conclude that either type of arrangement would threaten to give any single large buyer or lessee – or DE-buyer-lessee grouping – undue influence over a DE in the manner the FNPR sought to address. Instead, DEs that run afoul of the 50% rule may often employ a business model relying on a large number of relatively small-scale transactions with a group of third parties who compete against each other in the wireless services market. We regard this as exactly of the kind of DE independence that the FNPR was concerned with preserving, and the record contains no indication to the contrary.

Indeed, as we described above, the Second Report and Order makes clear that the FCC's real concern in promulgating the 50% impermissible-relationship rule was not to prevent DEs from being unduly influenced by large entities or groups of entities, but rather was to ensure that DEs are primarily engaged in offering wireless services to the public. But the FNPR had not so much as hinted that this was the objective of the rulemaking: it mentioned "service to the public" only twice, both times in the course of describing the FCC's obligation to ensure that DEs have access to capital to help them provide such service. *See* FNPR, 21 F.C.C.R. 1753 at 1757, 1767. Instead, as we have explained, the FNPR was

focused on maintaining the independence of DEs from larger entities.

We also find it instructive that the FCC had previously solicited broader comment on the permissibility of leasing arrangements involving DEs, and in much more specific terms than it did here. In 2003 the FCC issued a Report and Order and Further Notice of Proposed Rulemaking in *In re Promoting Efficient Use of Spectrum Through Elimination of Barriers to the Development of Secondary Markets*, 18 F.C.C.R. 20,604 (October 6, 2003), in which it significantly relaxed previous restrictions – which had applied to DEs and non-DEs alike – on the leasing or reselling of spectrum licenses. In promulgating this change, the FCC stated it had "sought to ensure that its approach would not invite circumvention of the underlying purposes of these designated entity-related policies and rules," *id.* at 20,627, and summarized the extensive comments it had received directly addressing both sides of the issue, *id.* at 20,629, before concluding that

> [a] designated entity and/or entrepreneur licensee may lease to any spectrum lessee and avoid the application of our unjust enrichment rules and/or transfer restrictions so long as the lease does not result in the lessee becoming a 'controlling interest' or affiliate that would cause the licensee to lose its designated entity or entrepreneur status.

Id. at 20,654-55. The Commission also sought comment on possible further rulemaking, asking:

> [s]hould we require a lessee to be eligible for the same level of competitive bidding benefits, such as bidding credits, as the licensee from which it is leasing? Should we require only that the lessee be qualified to hold the license? If so, do we impose unjust enrichment obligations on a lessee that is qualified for a lesser level of competitive bidding benefits?

Id. at 20,698. In the final rule that emerged from this additional process, the FCC reiterated that DEs were free to lease their spectrum so long as they met the requirements applicable to all licensees. Second Report and Order *In re Promoting Efficient Use of Spectrum through Elimination of Barriers to the Development of Secondary Markets*, 19 F.C.C.R. 17,503, 17,543-44 (2004) ("[W]e will . . . amend the language of our rules to clarify that, subject to the other eligibility restrictions . . . a designated entity or entrepreneur licensee may enter into a spectrum manager leasing arrangement with any spectrum lessee, regardless of the lessee's eligibility for designated entity or entrepreneur benefits.").

The contrast could not be more stark between the transparent discussion of DE leasing rights from 2003-04 on the one hand, and the run up to the rules promulgated in 2006 by the Second R&O on the other. The FNPR here gave no indication that the FCC intended to revisit an issue it had thoroughly addressed only three years before. Commenters could not reasonably have anticipated that, in inquiring in the FNPR whether leasing arrangements between DEs and large wireless carriers impaired the DEs' bona fide small business

status, the FCC was proposing to revise the general limits on DEs' ability to lease their spectrum to anyone at all. Even if this *was* the FCC's intent, "an unexpressed intention cannot convert a final rule into a 'logical outgrowth' that the public should have anticipated." *Shell Oil Co. v. EPA*, 950 F.2d 741, 751, 292 U.S. App. D.C. 332 (D.C. Cir. 1991). Accordingly, we hold that the 50% impermissible-relationship rule, as codified at 47 C.F.R. § 1.2110(b)(3)(iv)(A), was promulgated without the notice and comment required by the APA.[8]

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[8] Because we find the notice invalid under the APA, we do not reach the question of whether the rule was arbitrary or capricious. Nevertheless, we note the Commission's inattention to the nature of the wireless wholesaling business. Both the 25% and 50% rules apply to wholesaling of wireless services by DEs. The record discloses that to engage in wireless wholesaling, a licensee must do considerably more than obtain and then lease or resell the spectrum license itself. Instead, the wholesaler must build and operate the physical facilities required to transmit and receive wireless signals, and to transfer those signals to or from other networks or end users. It is *this* service that is sold at wholesale. This raises a separate set of questions and concerns from those raised when a DE merely monetizes its credits or partners with a large carrier, thus rendering the DE's separate existence a mere formality.

Given the extensive provision of services entailed in wireless wholesaling, it is not at all obvious that the FCC's rationale for the 50% impermissible-relationship rule – ensuring that DEs offer service to the public, rather than simply handing their spectrum over to larger carriers – should necessarily require prohibiting DEs from engaging primarily in the wholesale business, so long as they do not sell or lease overly large quantities of their capacity to any single lessee or buyer. The FCC appears to have failed to even acknowledge this issue. We commend it to the Commission's attention on remand.

D. The Ten Year Repayment Schedule

1. Notice and Comment Compliance

We last turn to Petitioners' challenges to the changes to 47 C.F.R. § 1.2111(d)(2)(i) that extended from five to ten years the period during which a licensee must repay its bidding credits, in whole or in part, if it loses its DE status. The FNPR plainly offered notice that the FCC was trying to determine the proper length of the repayment period attached to any *new* DE qualifications that it might adopt. Petitioners argue, however, that the FNPR did not indicate that the FCC was considering changing the repayment terms attached to then-existing DE qualifications. As we noted previously, much of the protest that greeted the new rules was directed toward this extension of the repayment term, and the alleged lack of notice of this change.

The FCC responds by noting that it has never attached differing bidding-credit repayment schedules to different qualifications for DE status, because this would permit DEs looking to enter into suspect relationships to structure their arrangements to minimize the penalty involved. Thus, the Commission maintains that by soliciting comment on the repayment period attached to new regulations in the FNPR, it implicitly proposed changing the corresponding period for existing rules. We disagree.

Noting our decision in *Wagner Electric Corp. v. Volpe*, 466 F.2d 1013 (3d Cir. 1972), Petitioners argue persuasively that this sort of implied notice is

insufficient unless all interested persons would reasonably be expected to perceive the implication. In *Wagner*, the National Highway Traffic Safety Administration (NHTSA) had published a notice of proposed rulemaking in which it proposed to eliminate the permissible failure rate for automobile turn signals and warning flashers. The effect of this change would have been to require that 100% of those products meet the NHTSA's standards for regularity of flashing, durability, and other features. After comments, however, the NHTSA concluded that 100% compliance with its current regulations was technologically infeasible. In the final rule, it nevertheless enacted the 100% compliance requirement, but dealt with the infeasibility problem by significantly relaxing the substance of the standards. On review, faced with the argument that its notice of proposed rulemaking had not presaged this change, the NHTSA argued that relaxing the substantive standards was a logical means of increasing the compliance rate, and noted that some of the commenters had actually suggested as much. *Id.* at 1018-19. We rejected this argument, holding that even if some sophisticated observers would have seen the connection between the stricter compliance that had been noticed and the lower standards eventually announced, the proper question under the APA was whether the agency had provided notice to all "interested parties." *Id.* at 1019. We held that the inferential notice purportedly provided by the NHTSA did not satisfy that standard. *Id.* at 1020-21.

Here, the FNPR solicited comment on the length of the bidding-credit repayment schedule attached to

any new DE qualifications. From this – and from the fact that the repayment schedule had previously always been uniform across all DE qualifications – the FCC argues that interested parties should have inferred that the repayment schedule for all qualifications was under review. As in *Wagner*, this purported inferential notice was insufficient to satisfy the APA.

Even if the kind of inferential notice the FCC advances were sufficient under the APA, we do not find the FNPR to provide such notice. Nothing in the record forecloses the commonsense conclusion that because some violations of DE status are more serious than others, it would make sense to attach more stringent penalties to them, including more severe bidding-credit repayment requirements. Thus, far from communicating the need for an across-the-board repayment period, to many interested parties, the FNPR's solicitation of comments only on the repayment schedule for the *proposed* qualifications could well have appeared to be an attempt to calibrate the penalties for violations of the new rules with those for violations of existing rules. Indeed, no commenter manifested an understanding that the FCC was considering changing the existing repayment schedule. The only commenter to suggest adopting a 10-year repayment period – MMTC, a petitioner here – specifically suggested that the FCC "*consider initiating an inquiry*" into doing so, apparently in an entirely separate rulemaking. Comments of the Minority Media and Telecomm'ns Council, J.A. at 586

(emphasis added).[9] Accordingly, we hold that the 10-year repayment schedule, to the extent it applies to qualifications for DE status that were in effect before its enactment, was adopted without the notice and comment required by the APA.[10]

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[9] The FCC also points to Council Tree's own request that the preexisting repayment schedule be applied to any new DE qualifications that might be adopted. *See* Comments of Council Tree Comm'ns, Inc., J.A. 497-99. But this does not even begin to manifest an understanding by Council Tree that the preexisting schedule might be *changed*.

[10] As we stated above, there was more than adequate notice that the new repayment schedule would apply to any *new* rules adopted by the FCC. Because we leave intact the 25% rule, there is therefore no notice-or-comment barrier to the 10-year schedule's application to that rule. Nonetheless, we find it necessary to vacate the 10-year schedule in whole, because we see no way to sever the FCC's legitimate adoption of the 10-year schedule with respect to the 25% rule from its unlawful application of the rule to other situations. The Second R&O set forth a single repayment schedule to govern all DE qualifications, both those created in the Second R&O and those that preexisted it. *See* 21 F.C.C.R. at 4794; 47 C.F.R. § 1.2111(d)(1). Thus, we can strike down the regulation as it applies to the preexisting qualifications only by invalidating it across the board.

Although we do not reach Petitioners' contention that the extended repayment schedule is arbitrary and capricious, we also note that the FCC does not appear to have thoroughly considered the impact of the extended repayment schedule on DEs' ability to retain financing. In the Reconsideration Order, the FCC concluded that a shorter time to liquidity of a DE's spectrum licenses was not necessary, because

> [i]n a recently concluded proceeding addressing the leasing of Education Broadcast Service spectrum, a broad cross-section of commenters, including a private equity investment firm, submitted evidence that

III.

The proper remedy remains to be considered. The FCC suggests that, to the extent we find the rules defective, we remand the matter without vacatur to permit it to correct the defects. Petitioners, by contrast, urge not only that we vacate the rules before remand, but also that we exercise our equitable authority to rescind Auctions 66 and 73.[11]

Petitioners' proposal is vigorously opposed by the FCC and by several intervenors and *amici*, including

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> insufficient capital would flow to businesses that want to develop that spectrum if the length of spectrum lease terms was limited to fifteen years. These parties argued that lessees needed access to the spectrum for thirty years or more in order to provide the necessary certainty to justify capital investment in the band. The Commission was 'persuaded by [this argument]. [Therefore,] we are not convinced that the appropriate investment horizon for designated entity status should be only three to seven years.

21 F.C.C.R. at 6717-18. From this comment, it seems that the FCC has confused the maximum period for which investors are willing to lock up their capital (before being able to liquidate the spectrum license, in the event the DE proves unprofitable) with the *minimum* period necessary for financiers to turn a profit on a successful investment in educational broadcast services. We commend this issue as well to the FCC's attention on remand.

[11] Petitioners acknowledge that several other much smaller auctions have been conducted under the new rules, and that the logic of their position would also support rescission of those results as well. Nevertheless, they request nullification only of Auctions 66 and 73.

some winners of Auctions 66 and 73.[12] The record gives no indication that these intervenors and *amici*, or other winners of Auctions 66 and 73, were anything but innocent third parties in relation to the FCC's improper rulemaking. We are thus loath to rescind the results of the auctions, since it would involve unwinding transactions worth more than $ 30 billion, upsetting what are likely billions of dollars of additional investments made in reliance on the results, and seriously disrupting existing or planned wireless service for untold numbers of customers. Moreover, the possibility of such large-scale disruption in wireless communications would have broad negative implications for the public interest in general.

In an attempt to address these concerns, Petitioners suggest that we nullify the auction results, but permit the winning bidders to keep their licenses unless and until they are won by another bidder at re-auction. This might mitigate the chaos of a rescission, but it could not eliminate the massive uncertainty, waste, and frozen development that would occur from the time of the rescission until the re-auction which, as the FCC might wish to adopt additional rules before the re-auction to replace the ones at issue here, could be a significant period of time. Additionally, some of the intervenors, who were winners in Auction 66 in 2006, note that the

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[12] The FCC, intervenors and *amici* also contest our jurisdiction to overturn the auction results. As we will explain, we would decline to exercise any jurisdiction we may have to rescind the auction results. Accordingly, we will not address this matter further.

state of the economy and the credit markets has changed dramatically since the auction; consequently, their participation in any re-auction might be impractical or impossible. A re-auction thus would unfairly require these intervenors to pay sums that they may not have in order to protect investments they have already made, and perhaps cannot recoup without the relevant spectrum licenses. Under these circumstances, we conclude that it would be imprudent and unfair to order rescission of the auction results.

But we are also unreceptive to the FCC's suggestion that we remand the matter without vacating the challenged rules. The FCC argues we are authorized to do so based on a balancing of "the seriousness of the . . . deficiencies (and thus the extent of doubt whether the agency chose correctly) and the disruptive consequences of an interim change that may itself be changed," *Chamber of Commerce of U.S. v. SEC*, 443 F.3d 890, 908, 370 U.S. App. D.C. 249 (D.C. Cir. 2006) (quoting *Allied-Signal, Inc. v. Nuclear Regulatory Comm'n*, 988 F.2d 146, 150-51, 300 U.S. App. D.C. 198 (D.C.Cir.1993)).[13] We find the deficiencies in the

[13] Petitioners argue that we are required to vacate any rules we find in violation of the APA, pointing out that the APA requires us to "hold unlawful *and set aside*" any such agency action. 5 U.S.C. § 706(2) (emphasis added). The FCC, however, cites to a case in which we remanded without vacatur, albeit without commenting on the issue. See *Am. Iron & Steel Inst. v. EPA*, 568 F.2d 284, 310 (3d Cir. 1977). Because we find remand without vacatur to be inappropriate on the facts of this case, we express no view as to whether we are authorized to order this remedy.

challenged rulemaking to be serious. On the other hand, vacating the 50% impermissible relationship rule will mean that DEs will be free to lease or wholesale as much of their spectrum as they wish, subject to revenue attribution should they lease or wholesale more than 25% of their spectrum to a single entity. Vacating the 10-year-hold rule will simply mean that DEs' repayment obligations will once again be governed by the previous 5-year schedule.[14] *See Abington Mem. Hosp. v. Heckler*, 750 F.2d 242, 244 (3d Cir. 1984) (citing *Action on Smoking and Health v. CAB*, 713 F.2d 795, 797, 230 U.S. App. D.C. 1 (D.C. Cir. 1983), for the proposition that "vacating or rescinding invalidly promulgated regulations has the effect of reinstating prior regulations"); *Paulsen v. Daniels*, 413 F.3d 999, 1008 (9th Cir. 2005) ("The effect of invalidating an agency rule is to reinstate the rule previously in force."). We do not regard either of these situations as likely to create any serious disruption. Accordingly, even assuming we have the authority to remand the matter without vacatur, we would decline to do so here. Instead, we will vacate the 50% and 10-year rules and remand the matter to the FCC.

IV.

In sum, the FCC's 25% attribution rule was promulgated after the public notice and opportunity

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[14] Because we will leave in place 47 C.F.R. § 1.2111(d)(1), which makes the repayment schedule of § 1.2111(d)(2)(i) applicable to violations of the new 25% attribution rule which we also leave in place, violations of the 25% rule will also be governed by the preexisting five-year schedule.

to comment required by the APA, and is not arbitrary and capricious. The 50% impermissible-relationship rule, however, was promulgated without the requisite notice and opportunity to comment. The 10-year bidding-credit repayment schedule likewise was promulgated in substantial and inseverable part without notice or comment. Accordingly, we will deny the petition with respect to the attributable-material-relationship rule articulated in 47 C.F.R. § 1.2110(b)(1) and (b)(3)(iv)(B). We will grant the petition with respect to the impermissible material relationship rule contained in 47 C.F.R. § 1.2110(b)(3)(iv)(A) and the 10-year-hold rule contained in 47 C.F.R.§ 1.2111(d)(2)(i). We will vacate the impermissible material relationship rule and the 10-year-hold rule, order the reinstatement of the previous version of 47 C.F.R. § 1.2111(d)(2), and remand the matter to the FCC for further proceedings.

STATUTORY APPENDIX

I. Administrative Procedure Act Pub L. No. 79-404 (60 Stat. 238)

As amended and codified in Title 5 of the United States Code § 500 et seq., Recodified by Pub L. No. 89-554, Sept. 6, 1966 (80 Stat. 383), the Administrative Procedure Act provides, in relevant part:

§ 551. Definitions

For the purpose of this subchapter—

(1) "agency" means each authority of the Government of the United States, whether or not it is within or subject to review by another agency, but does not include—

(A) the Congress;

(B) the courts of the United States;

(C) the governments of the territories or possessions of the United States;

(D) the government of the District of Columbia; or except as to the requirements of section 552 of this title [5 USCS § 552]—

(E) agencies composed of representatives of the parties or of representatives of organizations of the parties to the disputes determined by them;

(F) courts martial and military commissions;

(G) military authority exercised in the field in time of war or in occupied territory; or

(H) functions conferred by sections 1738, 1739, 1743, and 1744 of title 12; chapter 2 of title 41 [41 USCS §§ 101 et seq.]; subchapter II of chapter 471 of title 49 [49 USCS §§ 47151 et seq.]; or sections 1884, 1891-1902, and former section 1641(b)(2), of title 50, appendix;

(2) "person" includes an individual, partnership, corporation, association, or public or private organization other than an agency;

(3) "party" includes a person or agency named or admitted as a party, or properly seeking and entitled as of right to be admitted as a party, in an agency proceeding, and a person or agency admitted by an agency as a party for limited purposes;

(4) "rule" means the whole or a part of an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy or describing the organization, procedure, or practice requirements of an agency and includes the approval or prescription for the future of rates, wages, corporate or financial structures or reorganizations thereof, prices, facilities, appliances, services or allowances therefor or of valuations, costs, or accounting, or practices bearing on any of the foregoing;

(5) "rule making" means agency process for formulating, amending, or repealing a rule;

(6) "order" means the whole or a part of a final disposition, whether affirmative, negative, injunctive, or declaratory in form, of an agency in a matter other than rule making but including licensing;

(7) "adjudication" means agency process for the formulation of an order;

(8) "license" includes the whole or a part of an agency permit, certificate, approval, registration, charter, membership, statutory exemption or other form of permission;

(9) "licensing" includes agency process respecting the grant, renewal, denial, revocation, suspension, annulment, withdrawal, limitation, amendment, modification, or conditioning of a license;

(10)"sanction" includes the whole or a part of an agency—

(A) prohibition, requirement, limitation, or other condition affecting the freedom of a person;

(B) withholding of relief;

(C) imposition of penalty or fine;

(D) destruction, taking, seizure, or withholding of property;

(E) assessment of damages, reimbursement, restitution, compensation, costs, charges, or fees;

(F) requirement, revocation, or suspension of a license; or

(G) taking other compulsory or restrictive action;

(11)"relief" includes the whole or a part of an agency—

(A) grant of money, assistance, license, authority, exemption, exception, privilege, or remedy;

(B) recognition of a claim, right, immunity, privilege, exemption, or exception; or

(C) taking of other action on the application or petition of, and beneficial to, a person;

(12)"agency proceeding" means an agency process as defined by paragraphs (5), (7), and (9) of this section;

(13)"agency action" includes the whole or a part of an agency rule, order, license, sanction, relief, or the equivalent or denial thereof, or failure to act; and

* * * *

§ 553. Rule making

(a) This section applies, according to the provisions thereof, except to the extent that there is involved—

(1) a military or foreign affairs function of the United States; or

(2) a matter relating to agency management or personnel or to public property, loans, grants, benefits, or contracts.

(b) General notice of proposed rule making shall be published in the Federal Register, unless persons

subject thereto are named and either personally served or otherwise have actual notice thereof in accordance with law. The notice shall include—

(1) a statement of the time, place, and nature of public rule making proceedings;

(2) reference to the legal authority under which the rule is proposed; and

(3) either the terms or substance of the proposed rule or a description of the subjects and issues involved.

Except when notice of hearing is required by statute, this subsection does not apply—

(A) to interpretative rules, general statements of policy, or rules of agency organization, procedure, or practice; or

(B) when the agency for good cause finds (and incorporates the finding and a brief statement of reasons therefore in the rules issued) that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest.

(c) After notice required by this section, the agency shall give interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments with or without opportunity for oral presentation. After consideration of the relevant matter presented, the agency shall incorporate in the rules adopted a concise general statement of their basis and purpose. When rules are required by statute to be made on the record after opportunity for an agency hearing,

sections 556 and 557 of this title apply instead of this subsection.

(d) The required publication or service of a substantive rule shall be made not less than 30 days before its effective date, except—

(1) a substantive rule which grants or recognizes an exemption or relieves a restriction;

(2) interpretative rules and statements of policy; or

(3) as otherwise provided by the agency for good cause found and published with the rule.

(e) Each agency shall give an interested person the right to petition for the issuance, amendment, or repeal of a rule.

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§ 705. Relief pending review

When an agency finds that justice so requires, it may postpone the effective date of action taken by it, pending judicial review. On such conditions as may be required and to the extent necessary to prevent irreparable injury, the reviewing court, including the court to which a case may be taken on appeal from or on application for certiorari or other writ to a reviewing court, may issue all necessary and appropriate process to postpone the effective date of an agency action or to preserve status or rights pending conclusion of the review proceedings.

§ 706. Scope of review

To the extent necessary to decision and when

presented, the reviewing court shall decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of an agency action. The reviewing court shall—

(1) compel agency action unlawfully withheld or unreasonably delayed; and

(2) hold unlawful and set aside agency action, findings, and conclusions found to be—

(A) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law;

(B) contrary to constitutional right, power, privilege, or immunity;

(C) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right;

(D) without observance of procedure required by law;

(E) unsupported by substantial evidence in a case subject to sections 556 and 557 of this title or otherwise reviewed on the record of an agency hearing provided by statute; or

(F) unwarranted by the facts to the extent that the facts are subject to trial de novo by the reviewing court.

In making the foregoing determinations, the court shall review the whole record or those parts of it cited by a party, and due account shall be taken of the rule of prejudicial error.

II. Communications Act of 1934 Pub L. No. 416 (48 Stat. 1064)

As amended and codified in Chapter 5 of Title 47 of the United States Code, 47 U.S.C. § 151 et seq., the Communications Act of 1934, in relevant part:

§ 151 Purposes of Act, Creation of Federal Communications Commission

For the purpose of the regulating interstate and foreign commerce in communication by wire and radio so as to make available, so far as possible, to all the people of the United States, without discrimination, on the basis of race, color, religion, national origin, or sex, a rapid, efficient, Nation-wide, and world-wide wire and radio communication service with adequate facilities at reasonable charges, for the purpose of the national defense, for the purpose of promoting safety of life and property through the use of wire and radio communication, and for the purpose of securing a more effective execution of this policy by centralizing authority heretofore granted by law to several agencies and by granting additional authority with respect to interstate and foreign commerce in wire and radio communication, there is hereby created a commission to be known as the "Federal Communications Commission," which shall be constituted as hereinafter provided, and which shall execute and enforce the provisions of this Act.

§ 309(j)(1)&(2)

(j) USE OF COMPETITIVE BIDDING.—

(1) General authority.—If, consistent with the obligations described in paragraph (6)(E), mutually exclusive applications are accepted for any initial license or construction permit, then, except as provided in paragraph (2), the Commission shall grant the license or permit to a qualified applicant through a system of competitive bidding that meets the requirements of this subsection.

(2) EXEMPTIONS.—The competitive bidding authority granted by this subsection shall not apply to licenses or construction permits issued by the Commission—

(A) for public safety radio services, including private internal radio services used by State and local governments and non-government entities and including emergency road services provided by not-for-profit organizations, that—

(i) are used to protect the safety of life, health, or property; and

(ii) are not made commercially available to the public;

(B) for initial licenses or construction permits for digital television service given to existing terrestrial broadcast licensees to replace their analog television service licenses; or

(C) for stations described in Section 397(6) of this Act.

§ 309(j)(3)

(3) DESIGN OF SYSTEMS OF COMPETITIVE BIDDING.—For each class of licenses or permits that the Commission grants through the use of a competitive bidding system, the Commission shall, by regulation, establish a competitive bidding methodology. The Commission shall seek to design and test multiple alternative methodologies under appropriate circumstances. The Commission shall, directly or by contract, provide for the design and conduct (for purposes of testing) of competitive bidding using a contingent combinatorial bidding system that permits prospective bidders to bid on combinations or groups of licenses in a single bid and to enter multiple alternative bids within a single bidding round. In identifying classes of licenses and permits to be issued by competitive bidding, in specifying eligibility and other characteristics of such licenses and permits, and in designing the methodologies for use under this subsection, the Commission shall include safeguards to protect the public interest in the use of the spectrum and shall seek to promote the purposes specified in Section 1 of this Act and the following objectives:

(A) the development and rapid deployment of new technologies, products, and services for the benefit of the public, including those residing in rural areas, without administrative or judicial delays;

(B) promoting economic opportunity and competition and ensuring that new and innovative technologies are readily accessible to the American people by avoiding excessive concentration of licenses

and by disseminating licenses among a wide variety of applicants, including small businesses, rural telephone companies, and businesses owned by members of minority groups and women;

(C) recovery for the public of a portion of the value of the public spectrum resource made available for commercial use and avoidance of unjust enrichment through the methods employed to award uses of that resource;

(D) efficient and intensive use of the electromagnetic spectrum; and

(E) ensure that, in the scheduling of any competitive bidding under this subsection, an adequate period is allowed—

(i) before issuance of bidding rules, to permit notice and comment on proposed auction procedures; and

(ii) after issuance of bidding rules, to ensure that interested parties have a sufficient time to develop business plans, assess market conditions, and evaluate the availability of equipment for the relevant services.

§ 309(j)(4)

(4) CONTENTS OF REGULATIONS. In prescribing regulations pursuant to paragraph (3), the Commission shall—

(A) consider alternative payment schedules and methods of calculation, including lump sums or guaranteed installment payments, with or without royalty payments, or other schedules or

methods that promote the objectives described in paragraph(3)(B), and combinations of such schedules and methods;

(B) include performance requirements, such as appropriate deadlines and penalties for performance failures, to ensure prompt delivery of service to rural areas, to prevent stockpiling or warehousing of spectrum by licensees or permittees, and to promote investment in and rapid deployment of new technologies and services;

(C) consistent with the public interest, convenience, and necessity, the purposes of this Act, and the characteristics of the proposed service, prescribe area designations and bandwidth assignments that promote (i) an equitable distribution of licenses and services among geographic areas, (ii) economic opportunity for a wide variety of applicants, including small businesses, rural telephone companies, and businesses owned by members of minority groups and women, and (iii) investment in and rapid deployment of new technologies and services;

(D) ensure that small businesses, rural telephone companies, and businesses owned by members of minority groups and women are given the opportunity to participate in the provision of spectrum-based services, and, for such purposes, consider the use of tax certificates, bidding preferences, and other procedures;

(E) require such transfer disclosures and antitrafficking restrictions and payment schedules as may be necessary to prevent unjust enrichment as a

result of the methods employed to issue licenses and permits; and

(F) prescribe methods by which a reasonable reserve price will be required, or a minimum bid will be established, to obtain any license or permit being assigned pursuant to the competitive bidding, unless the Commission determines that such a reserve price or minimum bid is not in the public interest.

§ 309(j)(5)

(5) BIDDER AND LICENSEE QUALIFICATION.—No person shall be permitted to participate in a system of competitive bidding pursuant to this subsection unless such bidder submits such information and assurances as the Commission may require to demonstrate that such bidder's application is acceptable for filing. No license shall be granted to an applicant selected pursuant to this subsection unless the Commission determines that the applicant is qualified pursuant to subsection (a) and Sections 308(b) and 310. Consistent with the objectives described in paragraph (3), the Commission shall, by regulation, prescribe expedited procedures consistent with the procedures authorized by subsection (i)(2) for the resolution of any substantial and material issues of fact concerning qualifications.

§ 309(j)(6)

(6) RULES OF CONSTRUCTION.—Nothing in this subsection, or in the use of competitive bidding, shall—

(A) alter spectrum allocation criteria and procedures established by the other provisions of this Act;

(B) limit or otherwise affect the requirements of subsection (h) of this section, Sections 301, 304, 307, 310, or 706, or any other provision of this Act (other than subsections (d)(2) and (e) of this section);

(C) diminish the authority of the Commission under the other provisions of this Act to regulate or reclaim spectrum licenses;

(D) be construed to convey any rights, including any expectation of renewal of a license, that differ from the rights that apply to other licenses within the same service that were not issued pursuant to this subsection;

(E) be construed to relieve the Commission of the obligation in the public interest to continue to use engineering solutions, negotiation, threshold qualifications, service regulations, and other means in order to avoid mutual exclusivity in application and licensing proceedings;

(F) be construed to prohibit the Commission from issuing nationwide, regional, or local licenses or permits;

(G) be construed to prevent the Commission from awarding licenses to those persons who make significant contributions to the development of a new telecommunications service or technology; or

(H) be construed to relieve any applicant for a license or permit of the obligation to pay charges imposed pursuant to Section 8 of this Act.

§ 309(j)(7)

(7) CONSIDERATION OF REVENUES IN PUBLIC INTEREST DETERMINATIONS.—

(A) CONSIDERATION PROHIBITED.—In making a decision pursuant to Section 303(c) to assign a bank of frequencies to use for which licenses or permits will be issued pursuant to this subsection, and in prescribing regulations pursuant (4)(C) of this subsection, the Commission may not base a finding of public interest, convenience, and necessity on the expectation of Federal revenues from the use of a system of competitive bidding under this subsection.

(B) CONSIDERATION LIMITED.—In prescribing regulations pursuant to paragraph(4)(A) of this Subsection, the Commission may not base a finding of public interest, convenience, and necessity solely or predominantly on the expectation of Federal revenues from the use of a system of competitive bidding under this subsection.

(C) CONSIDERATION OF DEMAND FOR SPECTRUM NOT AFFECTED.—Nothing in this paragraph shall be construed to prevent the Commission from continuing to consider consumer demand for spectrum-based services.

§ 402. PROCEEDINGS TO ENJOIN, SET ASIDE, ANNUL OR SUSPEND ORDERS OF THE COMMISSION

(a) Any proceeding to enjoin, set aside, annul or suspend any order of the Commission under this Act (except those appealable under subsection (b) of this section) shall be brought as provided by and in the manner prescribed in Chapter 158 of Title 28, United States Code.

OTHER AUTHORITIES

I. FCC Rules & Regulations, 47 C.F.R. Ch. 1 (10-1-05 Edition)

The following sections are the pertinent FCC rules *prior* to the adoption of the *Second Report and Order and Second Further Notice of Proposed Rulemaking*, WT Docket No. 05-211, 21 F.C.C.R. 4753 (2006).

§ 1.2110 Designated entities.

(a) Designated entities are small businesses, businesses owned by members of minority groups and/or women, and rural telephone companies.

(b) *Eligibility for small business and entrepreneur provisions*—(1) *Size attribution.* (i) The gross revenues of the applicant (or licensee), its affiliates, its controlling interests, and the affiliates of the applicant's controlling interests shall be attributed to the applicant and considered on a cumulative basis and aggregated for purposes of determining whether the applicant (or licensee) is eligible for status as a small business, very small business, or entrepreneur, as those terms are defined in the service-specific rules. An applicant seeking status as a small business, very small business, or entrepreneur, as those terms are defined in the service-specific rules, must disclose on its short and long-form applications, separately and in the aggregate, the gross revenues of the applicant (or licensee), its affiliates, its controlling interests, and the affiliates of the applicant's controlling interests for each of the previous three years.

(ii) If applicable, pursuant to § 24.709 of this chapter, the total assets of the applicant (or licensee), its affiliates, its controlling interests and affiliates of the applicant's controlling interests shall be attributed to the applicant and considered on a cumulative basis and aggregated for purposes of determining whether the applicant (or licensee) is eligible for status as an entrepreneur. An applicant seeking status as an entrepreneur must disclose on its short and long-form applications, separately and in the aggregate, the gross revenues of the applicant (or licensee), its affiliates, its controlling interests and affiliates of the applicant's controlling interests for each of the previous two years.

* * * *

(c) *Definitions*—(1) *Small businesses.* The Commission will establish the definition of a small business on a service specific basis, taking into consideration the characteristics and capital requirements of the particular service.

* * * *

(4) *Rural telephone companies.* A rural telephone company is any local exchange carrier operating entity to the extent that such entity—

(i) Provides common carrier service to any local exchange carrier study area that does not include either:

(A) Any incorporated place of 10,000 inhabitants or more, or any part thereof, based on the most recently available population statistics of the Bureau of the Census, or

(B) Any territory, incorporated or unincorporated, included in an urbanized area, as defined by the Bureau of the Census as of August 10, 1993;

(ii) Provides telephone exchange service, including exchange access, to fewer than 50,000 access lines;

(iii) Provides telephone exchange service to any local exchange carrier study area with fewer than 100,000 access lines; or

(iv) Has less than 15 percent of its access lines in communities of more than 50,000 on the date of enactment of the Telecommunications Act of 1996.

* * * *

(f) *Bidding credits.* (1) The Commission may award bidding credits (*i.e.*, payment discounts) to eligible designated entities. Competitive bidding rules applicable to individual services will specify the designated entities eligible for bidding credits, the licenses for which bidding credits are available, the amounts of bidding credits and other procedures.

(2) *Size of bidding credits.* A winning bidder that qualifies as a small business or a consortium of small businesses may use the following bidding credits corresponding to their respective average gross revenues for the preceding 3 years:

(i) Businesses with average gross revenues for the preceding years, 3 years not exceeding $3 million are eligible for bidding credits of 35 percent;

(ii) Businesses with average gross revenues for the preceding years, 3 years not exceeding $15

million are eligible for bidding credits of 25 percent; and

(iii) Businesses with average gross revenues for the preceding years, 3 years not exceeding $40 million are eligible for bidding credits of 15 percent.

* * * *

§ 1.2111 Assignment or transfer of control: unjust enrichment.

* * * *

(d) *Unjust enrichment payment: bidding credits.* (1) A licensee that utilizes a bidding credit, and that during the initial term seeks to assign or transfer control of a license to an entity that does not meet the eligibility criteria for a bidding credit, will be required to reimburse the U.S. Government for the amount of the bidding credit, plus interest based on the rate for ten year U.S. Treasury obligations applicable on the date the license was granted, as a condition of Commission approval of the assignment or transfer. If, within the initial term of the license, a licensee that utilizes a bidding credit seeks to assign or transfer control of a license to an entity that is eligible for a lower bidding credit, the difference between the bidding credit obtained by the assigning party and the bidding credit for which the acquiring party would qualify, plus interest based on the rate for ten year U.S. treasury obligations applicable on the date the license is granted, must be paid to the U.S. Government as a condition of Commission approval of the assignment or transfer. If, within the initial term of the license, a licensee

that utilizes a bidding credit seeks to make any ownership change that would result in the licensee losing eligibility for a bidding credit (or qualifying for a lower bidding credit), the amount of the bidding credit (or the difference between the bidding credit originally obtained and the bidding credit for which the restructured licensee would qualify), plus interest based on the rate for ten year U.S. treasury obligations applicable on the date the license is granted, must be paid to the U.S. Government as a condition of Commission approval of the assignment or transfer.

(2) *Payment schedule.* (i) The amount of payments made pursuant to paragraph (d)(1) of this section will be reduced over time as follows:

(A) A transfer in the first two years of the license term will result in a forfeiture of 100 percent of the value of the bidding credit (or in the case of very small businesses transferring to small businesses, 100 percent of the difference between the bidding credit received by the former and the bidding credit for which the latter is eligible);

(B) A transfer in year 3 of the license term will result in a forfeiture of 75 percent of the value of the bidding credit;

(C) A transfer in year 4 of the license term will result in a forfeiture of 50 percent of the value of the bidding credit;

(D) A transfer in year 5 of the license term will result in a forfeiture of 25 percent of the value of the bidding credit; and

(E) for a transfer in year 6 or thereafter, there will be no payment.

(ii) These payments will have to be paid to the United States Treasury as a condition of approval of the assignment, transfer, or ownership change.

* * * *

II. FCC Rules & Regulations, 47 C.F.R. Ch. 1 (10-1-06 Edition)

The following sections are the pertinent FCC rules *after* adoption of the *Second Report and Order and Second Further Notice of Proposed Rulemaking*, WT Docket No. 05-211, 21 F.C.C.R. 4753 (2006) and modified in part by the *Order on Reconsideration of the Second Report and Order*, WT Docket No. 05-211, 21 F.C.C.R. 6703 (2006), and subject to the present litigation.

§ 1.2110 Designated entities.

(a) Designated entities are small businesses, businesses owned by members of minority groups and/or women, and rural telephone companies.

(b) *Eligibility for small business and entrepreneur provisions.*—(1) Size attribution. (i) The gross revenues of the applicant (or licensee), its affiliates, its controlling interests, the affiliates of its controlling interests, and the entities with which it has an attributable material relationship shall be attributed to the applicant (or licensee) and considered on a cumulative basis and aggregated for purposes of determining whether the applicant (or licensee) is eligible for status as a small business, very small business, or entrepreneur, as those terms are defined in the service-specific rules. An applicant seeking status as a small business, very small business, or entrepreneur, as those terms are defined in the service-specific rules, must disclose on its short- and long-form applications, separately and in the aggregate, the gross revenues for each of the previous three years of the applicant (or licensee), its

affiliates, its controlling interests, the affiliates of its controlling interests, and the entities with which it has an attributable material relationship.

(ii) If applicable, pursuant to § 24.709 of this chapter, the total assets of the applicant (or licensee), its affiliates, its controlling interests, the affiliates of its controlling interests, and the entities with which it has an attributable material relationship shall be attributed to the applicant (or licensee) and considered on a cumulative basis and aggregated for purposes of determining whether the applicant (or licensee) is eligible for status as an entrepreneur. An applicant seeking status as an entrepreneur must disclose on its short- and long-form applications, separately and in the aggregate, the gross revenues for each of the previous two years of the applicant (or licensee), its affiliates, its controlling interests, the affiliates of its controlling interests, and the entities with which it has an attributable material relationship.

* * * *

(3) *Exceptions.*

* * * *

(iv) *Applicants or licensees with material relationships*—(A) *Impermissible material relationships.* An applicant or licensee that would otherwise be eligible for designated entity benefits under this section and applicable service-specific rules shall be ineligible for such benefits if the applicant or licensee has an impermissible material relationship. An applicant or licensee has an impermissible material relationship when it has arrangements with one or

more entities for the lease or resale (including under a wholesale agreement) of, on a cumulative basis, more than 50 percent of the spectrum capacity of any one of the applicant's or licensee's licenses.

(B) *Attributable material relationships.* An applicant or licensee must attribute the gross revenues (and, if applicable, the total assets) of any entity, (including the controlling interests, affiliates, and affiliates of the controlling interests of that entity) with which the applicant or licensee has an attributable material relationship. An applicant or licensee has an attributable material relationship when it has one or more arrangements with any individual entity for the lease or resale (including under a wholesale agreement) of, on a cumulative basis, more than 25 percent of the spectrum capacity of any one of the applicant's or licensee's licenses.

(C) *Grandfathering*—(1) *Licensees.* An impermissible or attributable material relationship shall not disqualify a licensee for previously awarded benefits with respect to a license awarded before April 25, 2006, based on spectrum lease or resale (including wholesale) arrangements entered into before April 25, 2006.

(2) *Applicants.* An impermissible or attributable material relationship shall not disqualify an applicant seeking eligibility in an application for a license, authorization, assignment, or transfer of control or for partitioning or disaggregation filed before April 25, 2006, based on spectrum lease or resale (including wholesale) arrangements entered into before April 25, 2006. Any applicant seeking eligibility in an application for

a license, authorization, assignment, or transfer of control or for partitioning or disaggregation filed after April 25, 2006, or in an application to participate in an auction in which bidding begins on or after June 5, 2006, need not attribute the material relationship(s) of those entities that are its affiliates based solely on § 1.2110(c)(5)(i)(C) if those affiliates entered into such material relationship(s) before April 25, 2006, and are subject to a contractual prohibition preventing them from contributing to the applicant's total financing.

Example to paragraph (b)(3)(iv)(C)(2). Newco is an applicant seeking designated entity status in an auction in which bidding begins after the effective date of the rules. Investor is a controlling interest of Newco. Investor also is a controlling interest of Existing DE. Existing DE previously was awarded designated entity benefits and has impermissible material relationships based on leasing agreements entered into before April 25, 2006, with a third party, Lessee, that were in compliance with the Commission's designated eligibility standards prior to April 25, 2006. In this example, Newco would not be prohibited from acquiring designated entity benefits solely because of the existing impermissible material relationships of its affiliate, Existing DE. Newco, Investor, and Existing DE, however, would need to enter into a contractual prohibition that prevents Existing DE from contributing to the total financing of Newco.

(c) Definitions.—(1) *Small businesses.* The Commission will establish the definition of a small business on a service-specific basis, taking into

consideration the characteristics and capital requirements of the particular service.

* * * *

(4) *Rural telephone companies.* A rural telephone company is any local exchange carrier operating entity to the extent that such entity—

(i) Provides common carrier service to any local exchange carrier study area that does not include either:

(A) Any incorporated place of 10,000 inhabitants or more, or any part thereof, based on the most recently available population statistics of the Bureau of the Census, or

(B) Any territory, incorporated or unincorporated, included in an urbanized area, as defined by the Bureau of the Census as of August 10, 1993;

(ii) Provides telephone exchange service, including exchange access, to fewer than 50,000 access lines;

(iii) Provides telephone exchange service to any local exchange carrier study area with fewer than 100,000 access lines; or

(iv) Has less than 15 percent of its access lines in communities of more than 50,000 on the date of enactment of the Telecommunications Act of 1996.

* * * *

(f) *Bidding credits.* (1) The Commission may award bidding credits (*i.e.*, payment discounts) to eligible designated entities. Competitive bidding

rules applicable to individual services will specify the designated entities eligible for bidding credits, the licenses for which bidding credits are available, the amounts of bidding credits and other procedures.

(2) *Size of bidding credits.* A winning bidder that qualifies as a small business may use the following bidding credits corresponding to its respective average gross revenues for the preceding 3 years:

(i) Businesses with average gross revenues for the preceding years, 3 years not exceeding $3 million are eligible for bidding credits of 35 percent;

(ii) Businesses with average gross revenues for the preceding years, 3 years not exceeding $15 million are eligible for bidding credits of 25 percent; and

(iii) Businesses with average gross revenues for the preceding years, 3 years not exceeding $40 million are eligible for bidding credits of 15 percent.

* * * *

§ 1.2111 Assignment or transfer of control: unjust enrichment.

* * * *

(d) *Unjust enrichment payment: bidding credits.* (1) A licensee that utilizes a bidding credit, and that during the initial term seeks to assign or transfer control of a license to an entity that does not meet the eligibility criteria for a bidding credit, will be required to reimburse the U.S. Government for the amount of the bidding credit, plus interest based on

the rate for ten year U.S. Treasury obligations applicable on the date the license was granted, as a condition of Commission approval of the assignment or transfer. If, within the initial term of the license, a licensee that utilizes a bidding credit seeks to assign or transfer control of a license to an entity that is eligible for a lower bidding credit, the difference between the bidding credit obtained by the assigning party and the bidding credit for which the acquiring party would qualify, plus interest based on the rate for ten year U.S. treasury obligations applicable on the date the license is granted, must be paid to the U.S. Government as a condition of Commission approval of the assignment or transfer. If, within the initial term of the license, a licensee that utilizes a bidding credit seeks to make any ownership change or to enter into a material relationship (see § 1.2110) that would result in the licensee losing eligibility for a bidding credit (or qualifying for a lower bidding credit), the amount of the bidding credit (or the difference between the bidding credit originally obtained and the bidding credit for which the licensee would qualify after restructuring or entry into a material relationship), plus interest based on the rate for ten year U.S. treasury obligations applicable on the date the license is granted, must be paid to the U.S. Government as a condition of Commission approval of the assignment or transfer or of a reportable eligibility event (see § 1.2114).

(2) *Payment schedule.* (i) For licenses initially granted after April 25, 2006, the amount of payments made pursuant to paragraph (d)(1) of this section will be 100 percent of the value of the bidding

credit prior to the filing of the notification informing the Commission that the construction requirements applicable at the end of the initial license term have been met. If the notification informing the Commission that the construction requirements applicable at the end of the initial license term have been met, the amount of the payments will be reduced over time as follows:

(A) A loss of eligibility in the first five years of the license term will result in a forfeiture of 100 percent of the value of the bidding credit (or in the case of eligibility changing to qualify for a lower bidding credit, 100 percent of the difference between the bidding credit received and the bidding credit for which it is eligible);

(B) A loss of eligibility in years 6 and 7 of the license term will result in a forfeiture of 75 percent of the value of the bidding credit (or in the case of eligibility changing to qualify for a lower bidding credit, 75 percent of the difference between the bidding credit received and the bidding credit for which it is eligible);

(C) A loss of eligibility in years 8 and 9 of the license term will result in a forfeiture of 50 percent of the value of the bidding credit (or in the case of eligibility changing to qualify for a lower bidding credit, 50 percent of the difference between the bidding credit received and the bidding credit for which it is eligible); and

(D) A loss of eligibility in year 10 of the license term will result in a forfeiture of 25 percent of the value of the bidding credit (or in the case of eligibility

changing to qualify for a lower bidding credit, 25 percent of the difference between the bidding credit received and the bidding credit for which it is eligible).

(ii) For licenses initially granted before April 25, 2006, the amount of payments made pursuant to paragraph (d)(1) of this section will be reduced over time as follows:

(A) A transfer in the first two years of the license term will result in a forfeiture of 100 percent of the value of the bidding credit (or in the case of very small businesses transferring to small businesses, 100 percent of the difference between the bidding credit received by the former and the bidding credit for which the latter is eligible);

(B) A transfer in year 3 of the license term will result in a forfeiture of 75 percent of the value of the bidding credit;

(C) A transfer in year 4 of the license term will result in a forfeiture of 50 percent of the value of the bidding credit;

(D) A transfer in year 5 of the license term will result in a forfeiture of 25 percent of the value of the bidding credit; and

(E) For a transfer in year 6 or thereafter, there will be no payment.

(iii) These payments will have to be paid to the United States Treasury as a condition of approval of the assignment, transfer, ownership change, or reportable eligibility event (see § 1.2114).

* * * *

No. 10-834

In the Supreme Court of the United States

COUNCIL TREE INVESTORS, INC., ET AL., PETITIONERS

v

FEDERAL COMMUNICATIONS COMMISSION, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE FEDERAL RESPONDENTS IN OPPOSITION

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QUESTION PRESENTED

The court of appeals concluded that the Federal Communications Commission (FCC), in issuing two rules related to small business bidding credits for spectrum license auctions, had not complied with the notice and comment requirements of the Administrative Procedure Act, 5 U.S.C. 551 *et seq.* As a remedy for those violations, the court vacated both rules. The question presented is as follows:

Whether the court of appeals erred by not also setting aside two multi-billion dollar spectrum license auctions that the FCC had conducted while the two rules were in force.

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In the Supreme Court of the United States

No. 10-834

COUNCIL TREE INVESTORS, INC., ET AL., PETITIONERS

v.

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BRIEF FOR THE FEDERAL RESPONDENTS IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-51a) is reported at 619 F.3d 235. A prior decision of the court of appeals in this case is reported at 503 F.3d 284. The decisions of the Federal Communications Commission are reported at 21 F.C.C.R. 4753, 21 F.C.C.R. 6703, and 23 F.C.C.R. 5425.[1]

JURISDICTION

The judgment of the court of appeals was entered on August 24, 2010. On November 8, 2010, Justice Alito extended the time for filing a petition for a writ of cer-

[1] The Commission's orders are not included in the appendix to the petition for a writ of certiorari but are reproduced as an appendix to this brief.

tiorari to and including December 22, 2010, and the petition was filed on that date. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. The Communications Act of 1934, as amended, 47 U.S.C. 151 *et seq.*, authorizes the Federal Communications Commission (FCC or Commission) to award licenses to permit use of the electromagnetic spectrum to provide communications services. 47 U.S.C. 307, 309. Since 1993, the Communications Act has required the FCC to award many spectrum licenses "through a system of competitive bidding," *i.e.*, by auction. 47 U.S.C. 309(j)(1).

The statute directs the Commission, in designing auction procedures, to seek to promote a variety of sometimes competing objectives. These objectives include developing and deploying new technologies and services for the benefit of the public "without administrative or judicial delays"; promoting economic opportunity and competition by avoiding "excessive concentration of licenses and by disseminating licenses among a wide variety of applicants," including "designated entities" (DEs) such as small businesses and rural telephone companies; and avoiding "unjust enrichment." 47 U.S.C. 309(j)(3)(A)-(C); see 47 U.S.C. 309(j)(4) (directing the Commission to prescribe regulations to achieve these objectives). In implementing the auctions program, the Commission has sought "to find a reasonable balance" among the statute's competing goals. App., *infra*, 7a.

To promote the participation of DEs in spectrum license auctions, the Commission has awarded such entities bidding credits—that is, "percentage discounts on

winning bid amounts." App., *infra*, 8a.[2] An applicant for these benefits must demonstrate that its gross revenues, in combination with those of its "attributable" interest holders, fall below certain service-specific caps. *Id.* at 8a-9a (citing 47 C.F.R. 1.2110(b)). Since 2000, the FCC has applied a standard that attributes to an applicant its own gross revenues, as well as those of its "controlling interests" (*i.e.*, those entities that have *de jure* or *de facto* control over the applicant), its affiliates, and the affiliates of its controlling interests. *Id.* at 12a.

To ensure that small-business benefits are available only to bona fide small businesses, the agency has sought to "prevent companies from circumventing the objectives of the designated entity eligibility rules." Further Notice of Proposed Rulemaking, *Implementation of the Commercial Spectrum Enhancement Act & Modernization of the Commission's Competitive Bidding Rules & Procedures*, 21 F.C.C.R. 1753, 1757 (para. 6) (2006) (*Further Notice*). For example, the Commission has adopted unjust-enrichment rules requiring a DE that has benefitted from bidding credits to return some or all of those credits if it subsequently transfers its license to a non-DE or otherwise loses its eligibility for such benefits. At various times, the FCC's auction rules have required repayment of the entire bidding credit if the licensee lost its DE eligibility during

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[2] The Commission's rules define the term "designated entities" as "small businesses, businesses owned by members of minority groups and/or women, and rural telephone companies." 47 C.F.R. 1.2110(a). Following this Court's decision in *Adarand Constructors* v. *Pena*, 515 U.S. 200 (1995), which addressed the constitutionality of certain government affirmative action programs, DE benefits have been available only to small businesses, including rural telephone companies. See App., *infra*, 3a-4a n.8.

the ten-year license term.[3] At the time the Commission commenced the rulemaking challenged in this case, its rules required repayment if a licensee lost its eligibility during the first five years after winning the license. App., *infra*, 128a.

2. In administering the auction program, the FCC became aware that some putative DEs were "put[ting] themselves forward as small companies in order to qualify for auction discounts," despite having entered into agreements to lease their prospective spectrum rights to other entities that were not entitled to such benefits. See *Further Notice*, 21 F.C.C.R. at 1771 (Statement of Comm'r Copps). Other bidders reportedly had acquired discounted licenses not for the purpose of pursuing "actual business operations" but rather "as investments to be later sold for profit in the after-market." *United States* v. *Gabelli*, 345 F. Supp. 2d 313, 321-322 (S.D.N.Y. 2004); see John R. Wilke, *Gabelli, U.S. Discuss Settlement in Fraud Case; Pact to End Investigation of Cellular-Spectrum Bids Is Likely to Top $100 Million*, Wall St. J., June 1, 2006 at A3.

In February 2006, after petitioner Council Tree Communications, Inc., submitted a proposal to tighten some of the eligibility rules for DE benefits, the Commission issued a notice of proposed rulemaking. That

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[3] See, *e.g.*, Sixth Report and Order, *Implementation of Section 309(j) of the Communications Act - Competitive Bidding*, 11 F.C.C.R. 136, 180 (1995) (requiring total reimbursement of bidding credits if eligibility was lost at any time during the ten-year license term); Report and Order, *Amendment of the Commission's Rules to Establish Part 27, the Wireless Comme'ns Serv.*, 12 F.C.C.R. 10,785, 10,918-10,919 (1997) (providing for 100% reimbursement for loss of eligibility during the first five years of the license term, with declining reimbursement obligations for years five through ten).

notice sought comment on measures to "prevent companies from circumventing the objectives of the designated entity eligibility rules" and to ensure that DE benefits are "available only to bona fide small businesses." *Further Notice*, 21 F.C.C.R. at 1757.

In April 2006, after reviewing comments in response to the *Further Notice*, the Commission issued its *Second Report and Order*. That order tightened the agency's auction rules for designated entities in two relevant respects. First, with respect to leasing and resale arrangements, the Commission adopted two new eligibility restrictions designed to ensure that every recipient of DE benefits uses its licenses to provide telecommunications services directly to the public. App., *infra*, 20a-25a. One restriction—the 25% Attribution Rule—provided that "if a DE leases or resells (including at wholesale) more than 25% of its spectrum capacity to any single lessee or purchaser, it must add that lessee's or purchaser's revenues to its own to determine continued eligibility for DE credits." Pet. App. 33a. The other restriction—the 50% Impermissible Relationship Rule—"ma[de] license applicants or holders ineligible for DE benefits if they lease or resell (including at wholesale) more than 50% of their spectrum capacity" on an aggregate basis. *Id.* at 38a.

Second, to address concerns about license "flipping"—attempts by DEs "to immediately monetize their bidding credits by selling their spectrum licenses at market prices" (Pet. App. 5a)—the Commission strengthened its "unjust enrichment" rules by returning to a ten-year (rather than five-year) unjust enrichment period. This change meant that a DE that transferred its license to a non-DE or otherwise lost eligibility for those benefits during the first ten years of its license would

have to repay some or all of its bidding credits (the Ten-Year Repayment Schedule). See *id.* at 17a, 43a.

On May 5, 2006, Council Tree and its co-petitioners filed a request for expedited reconsideration of the *Second Report and Order*. See App, *infra*, 99a n.2. Because a major auction (the Advanced Wireless Services (AWS) auction) was impending, the Commission on its own motion issued an order on reconsideration before the comment period on Council Tree's request for reconsideration was closed. In that order, the FCC reaffirmed the new DE rules, while clarifying them in several respects. *Id.* at 98a-138a. Although the sua sponte order on reconsideration responded to all of Council Tree's arguments about the rules adopted in the *Second Report and Order*, Council Tree's request for reconsideration remained formally pending at the agency.

3. On June 7, 2006, petitioners filed a petition for review in the Third Circuit, challenging the *Second Report and Order*, the *Reconsideration Order*, and a public notice regarding the timing of the AWS auction.[4] See Pet. App. 24a. Petitioners also asked the court of appeals to stay the FCC's new DE rules and the upcoming AWS auction pending judicial review on the merits. *Ibid.* On June 29, 2006, the court of appeals denied petitioners' stay request, concluding that "[t]he public interest * * * militates strongly in favor of letting the auction proceed without altering the rules of the game at this late date." No. 06-2943, at 5 n.1, 6 (3d Cir. June 29, 2006). After briefing on the merits, the court of appeals dismissed the petition for review because petitioners had filed it before *Federal Register* publication of the

[4] Public Notice, AU Docket No. 06-30, *Auction of Advanced Wireless Services Licenses Rescheduled for August 9, 2006*, 21 F.C.C.R. 5598 (2006) (Auction Public Notice).

Reconsideration Order and while their own request for reconsideration was still pending at the agency. *Council Tree Commc'ns, Inc.* v. *FCC*, 503 F.3d 284, 287 (3d Cir. 2007).

4. Because petitioners' jurisdictional misstep led to a four-year gap between the filing of their initial petition for review and issuance of the decision on the merits of their claim, the FCC conducted several spectrum auctions while the revised DE rules were in effect.

In 2006 the FCC held the AWS auction.[5] That auction raised nearly $14 billion in winning bids (net of bidding credits). Pet. App. 26a. More than $375 million in proceeds from the AWS auction have already been spent by federal agencies to pay for the relocation of their users from the spectrum that the auction reassigned for commercial use.[6] In addition, winning bidders from that auction are now using the spectrum they won to provide service to millions of customers.[7]

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[5] Following the Commission's practice of designating auctions by number, this auction is referred to in the relevant Commission orders and the decision below as "Auction 66."

[6] See U S. Department of Commerce, *Relocation of Federal Radio Systems from the 1710-1755 MHz Spectrum Band Third Annual Progress Report* 3 (Mar. 2010), http://www ntia.doc.gov/reports/2010/CSEA_Report_20100407. pdf.

[7] See, *e.g* , Fourteenth Report, *Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993*, 25 F C.C.R. 11,407, 11,485 (para 116) (2010) (*Fourteenth Wireless Competition Report*) (noting T-Mobile's use of AWS spectrum to deploy advanced wireless services to U.S. cities covering hundreds of millions of people by the end of 2010); *id* at 11,462-11,463 (para. 72) (noting that Leap Wireless used, *inter alia*, AWS licenses to expand coverage from 53.9 million people in October 2008 to 80.5 million people in October 2009, and that MetroPCS used such licenses to expand coverage during the same period from 56 million people to 84.6 million people).

In early 2008, the Commission conducted another major auction. That auction involved the reapportionment of the 700 MHz spectrum that television broadcasters had relinquished in converting from analog to digital broadcast. The 700 MHz auction (referred to in the FCC's orders as "Auction 73") raised approximately $19 billion in winning bids, nearly doubling congressional estimates of its likely proceeds. News Release, FCC, *Statement by FCC Chairman Kevin J. Martin* 2 (March 18, 2008), http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-280887A1.pdf (*Martin Statement*); see Pet. App. 27a. The proceeds of the auction have been transferred to the United States Treasury, as required by statute, to support public safety and digital television transition initiatives.[8] 700 MHz license winners are now providing service using this spectrum in many markets.[9]

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[8] See Second Report and Order, *Service Rules for the 698-746, 747-762 and 777-792 MHz Bands*, 22 F.C.C.R. 15,289, 15,296, 15,405 (paras 15, 318) (2007) (*700 MHz Service Rules Order*) (citing the Digital Television Transition and Public Safety Act of 2005, Pub. L. No. 109-171, Tit. III, 120 Stat. 21), petition for review dismissed, *Council Tree Commc'ns, Inc.* v. *FCC*, 324 Fed. Appx 3 (D.C. Cir. 2009), *Martin Statement* at 1.

[9] See, *e.g.*, *Fourteenth Wireless Competition Report*, 25 F.C.C.R. at 11482 (para. 112) (noting that Verizon Wireless expected "to launch [advanced wireless services] in 25-30 markets in 2010 using its 700 MHz Band spectrum, and to expand [such] coverage to 210 markets covering 285 million people by 2013"); *id* at 11,484-11,485 (para. 115) (noting that AT&T planned to conduct trials for similar advanced mobile services using 700 MHz Band and AWS spectrum in 2010 and to begin deployment in 2011).

There was robust DE participation in both the AWS and 700 MHz auctions. In the AWS auction, DEs accounted for 166 of 252 auction applicants; 100 of the 168 total qualified bidders; and 57 of the 104 total winning bidders. Pet. App. 26a. DEs submitted $551 million in winning bids. *Ibid.* Two DEs were among the top ten winners in dollar amount. *Ibid.* In the 700 MHz auction, 119 of the 214 total qualified bidders and 56 of 101 total winning bidders were DEs. *Id.* at 27a. In all, DEs won 35% of the individual licenses auctioned in the 700 MHz auction. *Ibid.* While the dollar value of the licenses won by DEs in these auctions was less than in some prior auctions, the court of appeals noted that such "data must be considered in light of the absence from [these two auctions] of the set-asides by which, in prior auctions, only DEs had been permitted to purchase certain spectrum blocks." *Id.* at 27a n.4. In addition, "the purpose of the instant rulemaking from its inception was to disqualify sham DEs, which would be expected to reduce the number of qualifying DEs." *Ibid.*

5. After the Commission formally denied petitioners' reconsideration petition (App., *infra*, 151a-153a), whose pendency had required dismissal of their first petition for review, petitioners filed a new petition for review in the Third Circuit. That petition, filed shortly after the 700 MHz auction ended,[10] led to the opinion at issue in this case. Petitioners contended that the new DE rules violated the Communications Act, were arbitrary and capricious, and were issued in violation of the

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[10] Petitioner Council Tree attempted to seek review in the D.C Circuit of the Commission's application of the modified DE rules to the 700 MHz auction, but, like its earlier petition in the Third Circuit, that petition was dismissed on jurisdictional grounds. See *Council Tree Commc'ns, Inc.* v. *FCC*, 324 Fed. Appx. 3, 4 (D.C. Cir. 2009).

notice-and-comment requirements of the Administrative Procedure Act (APA). Petitioners asked that the rules be vacated and that the court nullify both the AWS and 700 MHz auctions and order that those auctions be conducted again under revised DE rules. Pet. App. 33a, 47a.

The court of appeals granted the petition in part and denied it in part. Pet. App. 1a-51a. The court rejected petitioners' contention that the revised DE rules were inconsistent with the Communications Act. *Id.* at 28a-29a n.7. The court noted that, although the statute required that the Commission's auction rules allow for the "disseminat[ion] [of] licenses among a wide variety of applicants, including small businesses [and] rural telephone companies," the statute also included other, competing requirements. *Ibid.* (quoting 47 U.S.C. 309(j)(3)(B)). The court of appeals explained that, "[g]iven the general agreement that the DE program can be abused, as well as the continuing participation by DEs in auctions held under the new rules, we cannot conclude that the FCC has failed to promote small-business participation at all." *Id.* at 29a n.7.

Turning to petitioners' APA claims, the court reached different conclusions for different rules. The court rejected petitioners' notice-and-comment and arbitrary-and-capricious challenges to the 25% Attribution Rule, and it accordingly upheld that rule. Pet. App. 33a-37a. The court determined, however, that the Commission had provided inadequate notice of the 50% Impermissible Relationship Rule and the Ten-Year Repayment Schedule. *Id.* at 38a-46a.[11] Having reached that

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[11] The court found no notice defect with respect to the Ten-Year Repayment Schedule insofar as it applied to the 25% Attribution Rule,

conclusion, the court found it unnecessary to consider petitioners' further argument that those rules were arbitrary and capricious. *Id.* at 42a n.8, 46a n.10.

In considering the appropriate remedy for the violations it had found, the court of appeals noted that petitioners had urged it to vacate the DE rules, while the FCC had urged it to "remand the matter without vacatur to permit [the FCC] to correct the defects." Pet. App. 47a. The court also noted that the parties disagreed on its authority to remand the DE rules without vacatur: the FCC had argued that this remedy was within the court's equitable authority, while petitioners had contended that the APA required it "to vacate any rules we find in violation of the APA." *Id.* at 49a & n.13. The court "express[ed] no view as to whether [it was] authorized to" remand the DE rules without vacating them because it found such a remedy "inappropriate on the facts of this case." *Id.* at 49a n.13. Because the court viewed the APA notice violations as "serious," and because it believed that vacatur of the two rules would not be disruptive, the court agreed with petitioners that the rules should be vacated. *Id.* at 50a ("[E]ven assuming we have the authority to remand the matter without vacatur, we would decline to do so here.").

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since "there was more than adequate notice that the new repayment schedule would apply to any *new* rules adopted by the FCC." Pet. App 46a n.10. But because the court concluded that notice was insufficient to apply the new schedule to *pre-existing* DE eligibility restrictions—and the court saw "no way to sever the FCC's legitimate adoption of the ten-year schedule with respect to the 25% rule from its unlawful application of the rule to other situations"—the court vacated the Ten- Year Repayment Schedule in its entirely and specified that the effect of such vacatur would be to restore the pre-existing five-year schedule. *Id* at 46a n.10, 50a.

The court of appeals noted that petitioners had requested, as a separate remedy, that the court "exercise [its] equitable authority to rescind Auctions 66 and 73." Pet. App. 47a. The court also noted (*id.* at 48a n.12; see *id.* at 27a n.5) that the federal respondents and other parties had contested the court's jurisdiction to review the auctions, which were distinct proceedings with their own agency orders that petitioners had not timely challenged. The court determined that it need not address those jurisdictional arguments because, in exercising its "equitable authority" to fashion an appropriate remedy, it "would decline to exercise any jurisdiction [it] may have to rescind the auction results." *Id.* at 48a n.12.

The court of appeals explained that petitioners' request to rescind the AWS and 700 MHz auctions was "vigorously opposed" by intervenors and *amici*, some of which had won licenses in those auctions and were "innocent third parties in relation to" the notice defects in the DE rulemaking. Pet. App. 47a-48a. The court pointed out that rescinding the auctions "would involve unwinding transactions worth more than $30 billion, upsetting what are likely billions of dollars of additional investment made in reliance on the results, and seriously disrupting existing or planned wireless service for untold numbers of customers." *Id.* at 48a. Such potential "large-scale disruption in wireless communications," the court observed, "would have broad negative implications for the public interest in general." *Ibid.*

The court of appeals further determined that petitioners' proposed solution to the disruption—allowing the winning bidders "to keep their licenses unless and until they are won by another bidder at re-auction"—"might mitigate the chaos of a rescission, but it could not eliminate the massive uncertainty, waste, and frozen develop-

ment that would occur" during the period preceding any re-auction. Pet. App. 48a. For all these reasons, the court concluded that, under the circumstances, it would be "imprudent and unfair to order rescission of the auction results." *Id.* at 49a.

ARGUMENT

Petitioners contend that, once the court of appeals found that the FCC had violated the APA's notice-and-comment provisions in promulgating two of the challenged DE rules, 5 U.S.C. 706(2) required the court not only to vacate those rules but also to rescind two multi-billion dollar spectrum license auctions that had taken place while the rules were in force. The court of appeals correctly declined to impose that extraordinarily disruptive remedy, and its decision does not conflict with any decision of this Court or another court of appeals. Moreover, petitioners did not argue below that Section 706(2) of the APA required the court of appeals to nullify the auctions, so the principal contention in their petition has been waived. Further review is not warranted.

1. Petitioners ask the Court to address what they claim is a division in the circuits on whether the APA permits courts that find procedural defects in agency rules to remand those rules to the agency for correction without vacating them, or instead requires automatic vacatur upon a finding of error. Pet. 15-23. That question is not presented here. Although the federal respondents asked the court of appeals for a remand of the DE rules without vacatur, the court *declined* to limit its remedy in that manner. Pet. App. 49a-50a. Instead, it vacated the two DE rules whose promulgation it found defective, just as petitioners asked it to do. *Id.* at 50a.

In addressing this remedial question, the court of appeals noted petitioners' contention that the APA "required [it] to vacate any rules [it] f[ou]nd in violation of the APA." Pet. App. 49a n.13. The court "express[ed] no view" on that question, however, because it found remand without vacatur inappropriate "on the facts of this case." *Ibid.* Petitioners identify no sound reason for this Court to review a question on which petitioners prevailed below.[12]

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[12] Although the court of appeals found it unnecessary to address the question in this case, other circuits have held that, in appropriate circumstances, a court of appeals that finds an agency rule to have been invalidly promulgated may remand that rule to the agency without vacating it. See, *e.g.*, *Allied Signal, Inc.* v. *United States Nuclear Regulatory Comm'n*, 988 F.2d 146, 150-151 (D.C. Cir. 1993). Contrary to petitioners' contention (Pet. 19-21), the Tenth and Federal Circuits have not held to the contrary. *Forest Guardians* v. *Babbitt*, 174 F.3d 1178 (10th Cir. 1999), involved 5 U.S.C. 706(1), not 5 U.S.C. 706(2). 174 F.3d at 1187. When Section 706(2) is at issue, the Tenth Circuit holds that it has the authority to remand without vacating. *Qwest Corp.* v. *FCC*, 258 F.3d 1191, 1205, 1207 (2001), see *Qwest Corp.* v. *FCC*, No. 99-9546, Order of Clarification 4 (10th Cir. filed Aug. 27, 2001) (explaining that its reported opinion "did not vacate the rules" at issue, which "may remain in effect * * * pending the completion of * * * proceedings on remand"). The court in *PGBA, LLC* v. *United States*, 389 F.3d 1219 (Fed. Cir. 2004), did not address whether Section 706(2) permits a reviewing court to remand without vacating an agency order. The court in that case was construing another statute, which incorporated by reference the APA's substantive arbitrary-and-capricious standard but did not incorporate Section 706's remedial standards. *Id.* at 1225-1226. By contrast, when the Federal Circuit has directly addressed the question whether the APA permits remand without vacatur, it has held that "[a]n inadequately supported rule * * * need not necessarily be vacated." *National Org. of Veterans' Advocates, Inc.* v. *Secretary of Veterans Affairs*, 260 F.3d 1365, 1380 (2001) (quoting *Allied Signal*, 988 F.2d at 150, 151).

Petitioners now attempt to shift their Section 706(2) argument to the completely separate remedial question decided by the court of appeals, *i.e.*, whether the court should have nullified both the AWS and 700 MHz auctions in addition to vacating the two DE rule changes. Before the court of appeals, however, petitioners did not contend that Section 706(2) required the auctions to be unwound once a procedural defect in the DE rules was identified. Their contention that Section 706(2) made vacatur mandatory was made exclusively in service of their argument that the DE rules themselves should be vacated, rather than merely remanded. See Pet. 2008 C.A. Br. 25 n.43. With respect to rescission of the relevant auctions, petitioners did not argue below that Section 706(2) required that remedy; they contended only that the court should "exercise its equitable authority" to impose it. Pet. App. 47a; Pet. 2008 C.A. Br. 26-37. The court of appeals accordingly did not consider the question whether Section 706(2) required rescission of the auctions.[13] Petitioners' waiver of the principal claim they now advance is a sufficient reason to deny their petition. See *Pennsylvania Dep't of Corr.* v. *Yeskey*, 524 U.S. 206, 212-213 (1998) ("Where issues are neither raised before nor considered by the Court of Appeals, this Court will not ordinarily consider them.") (quoting *Adickes* v. *S.H. Kress & Co.*, 398 U.S. 144, 147 n.2 (1970)).

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[13] Petitioners state that "[t]he Third Circuit did not question that the auctions in this case—conducted pursuant to unlawfully issued rules—constituted unlawful agency action subject to Section 706's 'shall . . . set aside' command." Pet. 29. The Third Circuit had no occasion to "question" that proposition, however, because petitioners never advanced it.

Even if petitioners had preserved this contention, it would fail on the merits. The provision on which petitioners rely provides that a "reviewing court shall * * * hold unlawful and set aside *agency action*, findings, and conclusions found to be * * * without observance of procedure required by law" or arbitrary and capricious. 5 U.S.C. 706(2) (emphasis added). For two independent reasons, this provision did not require nullification of the auctions. First, with respect to the auctions, the court of appeals did not have properly before it any "agency action" that could have been "set aside." In a case like this, a timely petition for review of an FCC "order" is the exclusive basis of a court of appeals' jurisdiction. 47 U.S.C. 402(a); 28 U.S.C. 2342(1). Here, petitioners eventually filed a proper petition for review challenging the modifications to the FCC's generally applicable DE rules. They did not, however, timely challenge any order regarding the AWS or 700 MHz auctions.[14] The

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[14] Petitioners attempted to challenge an auction notice scheduling the AWS auction, but their effort was untimely. Petitioners timely challenged that public notice as part of their 2006 petition for review, but when the court of appeals dismissed that petition, they did not ask the court to retain jurisdiction over the public notice. Instead, they sought to challenge it anew in 2008, but the 60-day window for challenging that notice, 28 U.S.C. 2344, had closed more than two years earlier. The period for seeking review was not tolled by petitioners' request for administrative reconsideration, which pertained only to the DE rulemaking orders and not the public notice. In their petition for review in this case, petitioners did not even attempt to challenge any order regarding the 700 MHz auction. They did so in the D.C. Circuit, but, as noted, that petition was dismissed on jurisdictional grounds. *Council Tree Commc'ns*, 324 Fed. Appx. at 4; see note 10, *supra*.

court of appeals accordingly lacked jurisdiction to provide any remedy regarding those distinct proceedings.[15]

Second, petitioners' claim would fail even if there had been an auction order properly before the court of appeals because that court nowhere found that the Commission's decision to hold the auctions under its revised DE rules violated any provision of the APA. Accordingly, even if petitioners were correct in arguing that Section 706(2) mandates vacatur of any agency action found to be unlawful, petitioners would at most be entitled to vacatur of the orders modifying the DE rules (a remedy that the court of appeals awarded in any event as an exercise of discretion). Section 706(2) would not require the court to "set aside" *separate* "agency action[s]," such as the auctions in this case, that the court had *not* "found to be" "arbitrary [or] capricious" or "without observance of procedure required by law." 5 U.S.C. 706(2).

Finally, petitioners identify no court of appeals decision that has accepted the argument they now advance —*i.e.*, that the APA requires a court that finds procedural error in the promulgation of agency rules to "set aside" not only the rules themselves, but also the outcome of entirely separate proceedings, with their own orders and agency docket numbers and in which the court found no legal error. Absent any conflict in the

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[15] To the extent that petitioners claim that the FCC's award of licenses from the auctions was the "agency action" before the court of appeals, Pet. 29 n.22, that contention fails for multiple reasons. Petitioners never made that argument below; they did not challenge any order granting licenses in the court of appeals; and the D.C. Circuit has exclusive jurisdiction over appeals by "any person who is aggrieved or whose interests are adversely affected by any order of the Commission granting or denying," *inter alia*, any license application. 47 U.S.C. 402(b)(6).

circuits on this question, petitioners' claim would not warrant this Court's review even if that claim had been properly preserved.

2. In the alternative, petitioners contend that the court of appeals abused its equitable discretion in declining to nullify the auctions. Pet. 28-34. The court of appeals' record-intensive resolution of that question does not conflict with any decision of this Court or of any other court of appeals. Moreover, for the reasons stated above, the court of appeals was without jurisdiction to nullify the auctions because petitioners failed to timely challenge any auction order.[16] In any event, the court of appeals correctly declined to provide petitioners with the extraordinarily disruptive remedy they sought.

As the court of appeals noted, rescinding the auctions "would involve unwinding transactions worth more than $30 billion, upsetting what are likely billions of dollars of additional investments made in reliance on the results, and seriously disrupting existing or planned wireless service for untold numbers of customers." Pet. App. 48a. Such a step would also directly harm "innocent third parties." *Id.* at 47a-48a. Among them would be customers whose mobile devices would stop working when their providers lost their licenses, as well as companies that secured spectrum licenses in the auctions, including DEs that filed an amicus brief in the court of appeals "vigorously" opposing rescission as directly contrary to their interests. *Ibid.*; Atlantic Wireless 2008 C.A. Br. 8-10 (discussing irreparable harm auction rescission would cause to innocent small and medium-size companies that had won licenses in AWS auction). Un-

[16] The court of appeals did not find it necessary to reach this jurisdictional question since it found that rescission of the auctions would be unwarranted even assuming it had jurisdiction. Pet. App. 27a n.5.

winding the auctions would cause enduring systemic harms as well. Taking away spectrum licenses years after the auctions were held, the licenses had issued, companies had spent billions of dollars building facilities, and millions of customers had begun utilizing resulting services would significantly undermine confidence in the auction system as a whole and make bidders significantly less likely to participate in the future.

Petitioners have suggested that the court of appeals should "nullify the auction results, but permit the winning bidders to keep their licenses unless and until they are won by another bidder at re-auction." Pet. App. 48a. As the court below correctly recognized, that approach "might mitigate the chaos of a rescission, but it could not eliminate the massive uncertainty, waste, and frozen development that would occur from the time of the rescission until the re-auction." *Ibid.* "A re-auction * * * would unfairly require [auction winners] to pay sums that they may not have in order to protect investments they have already made, and perhaps cannot recoup without the relevant spectrum licenses." *Id.* at 49a.

Finally, the relief petitioners sought was especially inappropriate because their own failure to comply with jurisdictional requirements in 2006 led to dismissal of their first petition for review and a multi-year postponement of a decision on the merits. The 700 MHz auction took place during that interval, and reliance by both licensees and customers on the results of both auctions steadily increased during that time period. As a matter of equity, petitioners should not be allowed to leverage their own litigation mistakes into a claim for more expansive and disruptive relief. In sum, the court of appeals correctly concluded that "it would be imprudent

and unfair to order rescission of the auction results." Pet. App. 49a.

Petitioners are also wrong in contending (Pet. 29) that the court of appeals "declined to provide any remedy at all to petitioners injured by the unlawful agency action." The court of appeals vacated the rules whose issuance it found procedurally improper. Pet. App. 50a. Petitioners thus secured the remedy that courts of appeals typically provide when they find agency regulations to have been unlawfully promulgated. Indeed, when the court of appeals issued its decision, petitioner Council Tree recognized the significance of the relief it had obtained, stating that the decision had "restored a pathway for wireless competition, innovation and diversity by ensuring the 'dissemination of licenses among a wide variety of applicants' envisioned by Congress in establishing the FCC's wireless auction authority." TRDaily, *Third Circuit Vacates, Remands Portion of FCC's 'DE' Regulations* (Aug. 24, 2010).

Because the court of appeals vacated the 50% Impermissible Relationship Rule and the Ten-Year Repayment Schedule, petitioners may participate in future auctions of spectrum licenses without being subject to those restrictions. An auction of additional licenses in the 700 MHz Band currently is scheduled for July 2011, Public Notice, AU Docket No. 10-248, *Auction of 700 MHz Band Licenses Scheduled for July 19, 2011*, DA 10-2298 (Dec. 15, 2010), and more significant auctions are on the horizon, see Office of the White House Press Secretary, *President Obama Details Plan to Win the Future through Expanded Wireless Access* (Feb. 10, 2011), http://www.whitehouse.gov/the-press-office/2011/02/10/president-obama-details-plan-win-future-through-expanded-wireless-access.

Moreover, a DE that was one of the top ten winning bidders in the AWS auction and in which Council Tree's principals have had an acknowledged ownership interest,[17] already has received a tangible benefit from the decision below. On December 27, 2010, that winning bidder transferred to a non-DE its control of a portion of the AWS license it had won at auction. In doing so, the winning bidder paid the reduced unjust enrichment payment associated with the five-year repayment schedule that the court of appeals had reinstated, rather than the greater payment that would have been required under the now-vacated 10-year schedule.[18] In short, there is no basis for petitioners' contention that the court's failure to rescind the AWS and 700 MHz auctions left petitioners without any remedy.

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[17] Public Notice, *Auction of Advanced Wireless Service Licenses Closes*, 21 F C C R. 10,521, 10,582 (2006); see Gov't 2006 C.A. Br. 44 n.57; Pet. 2006 Reply Br. 27 n.26.

[18] See FCC File No. 0004404302, Application for Transfer of Control of Denali Spectrum License Sub , LLC (filed Oct. 1, 2010), available at http://wireless2.fcc.gov/UlsApp/ApplicationSearch/applMain.jsp?applID=5732431. An attachment to the application (scroll to Attachments and click on the link "Calculations for Unjust enrichment payment") provides unjust-enrichment calculations showing a payment of 50% of relevant bidding credit calculated, pursuant to the five-year repayment schedule of 47 C.F.R. 1 2111(d)(2)(ii)(C), rather than the 100% unjust enrichment payment that would have been applicable under the vacated Ten-Year Repayment Schedule (see 47 C.F.R. 1.2111(d)(2)(i)(A)). See generally RCRWireless, *Leap Completes Denali Acquisition* (Dec. 28, 2010), http://www.rcrwireless.com/article/20101228/carriers/101229949/leap-completes-denali-acquisition.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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FEBRUARY 2011

APPENDIX A

FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

WT Docket No. 05-211

IN THE MATTER OF IMPLEMENTATION OF THE COMMERCIAL SPECTRUM ENHANCEMENT ACT AND MODERNIZATION OF THE COMMISSION'S COMPETITIVE BIDDING RULES AND PROCEDURES

Adopted: Apr. 25, 2006
Released: Apr. 25, 2006

SECOND REPORT AND ORDER AND SECOND FURTHER NOTICE OF PROPOSED RULE MAKING

Comment Date: 60 days after publication in the Federal Register

Reply Comment Date: 90 days after publication in the Federal Register

By the Commission: Chairman Martin and Commissioner Copps issuing separate statements; and Commissioner Adelstein approving in part, dissenting in part, and issuing a separate statement.

I. INTRODUCTION

1. In this *Second Report and Order* and *Second Further Notice of Proposed Rule Making* ("*Second Further Notice*"), we address our rules concerning the eligibility of applicants and licensees for designated entity benefits. In the *Second Report and Order*, we modify our rules in order to increase our ability to ensure that the recipients of designated entity benefits are limited to those entities and for those purposes Congress intended.[1] In the *Second Further Notice*, we seek comment on a variety of additional measures that might further augment the effectiveness of our rules in this regard. We take all of these steps with the goal of enhancing our ability to carry out Congress's dual directives with regard to designated entities: (1) that we ensure that designated entities are given the opportunity to participate in the provision of spectrum-based services;[2] and (2) that, in providing such opportunity, we prevent unjust enrichment.[3] With regard to the second directive, our particular intention is to ensure that entities ineligible for designated entity incentives cannot circumvent our rules by obtaining those benefits indirectly, through their relationships with eligible entities.

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[1] "Designated entities" are small businesses, businesses owned by members of minority groups and/or women, and rural telephone companies 47 C.F R. § 1.2110(a). In an effort to eliminate some past inconsistency in nomenclature, we clarify that, unless otherwise noted, when referring to "designated entities," we include as a subgroup "entrepreneurs" eligible to bid for "set-aside" broadband Personal Communications Service ("broadband PCS") licenses offered in closed bidding. *See id.* §§ 1.2110(a), 24.709

[2] 47 U.S.C. § 309(j)(4)(D); *see also id* § 309(j)(3)(B)

[3] *Id.* § 309(j)(4)(E); *see also id.* § 309(j)(3)(C).

2. In the *Further Notice of Proposed Rule Making* in this docket ("*Further Notice*"), we tentatively concluded that we should restrict the award of designated entity benefits to an otherwise qualified applicant where it has a "material relationship" with a "large in-region incumbent wireless service provider."[4] We sought comment on how we should define the elements of such a restriction.[5] We further sought comment on whether we should restrict the award of designated entity benefits where an otherwise qualified applicant has a "material relationship" with a large entity that has a significant interest in communications services, and if so, how we should define the elements of such a restriction.[6]

A. *Second Report and Order*

3. As discussed fully below, we revise our general competitive bidding rules ("Part 1" rules)[7] governing benefits reserved for designated entities[8] to include cer-

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[4] Implementation of the Commercial Spectrum Enhancement Act and Modernization of the Commission's Competitive Bidding Rules and Procedures, WT Docket No 05-211, *Further Notice of Proposed Rule Making*, 21 FCC Rcd 1753 (2006) ("*Further Notice*").

[5] *Id.* at 1754-55 ¶ 1.

[6] *Id.* In response, we received 37 comments and 18 reply comments. Two parties who filed initial comments in response to the Commission's Public Notice relating to AWS auction procedures (AU-06-30) also raised issues with respect to the Commission's designated entity program. We also received *ex parte* filings in response to the *Further Notice* from various parties including the Congressional Black Caucus, the U.S. Department of Justice and Council Tree. Appendix A contains a list of full and abbreviated names of commenting parties

[7] *See* 47 C.F.R. § 1.2101 *et seq.*

[8] *See id.* § 1.2110. The Commission establishes special small business size standards on a service-specific basis, taking into consideration the

tain "material relationships" as factors in determining designated entity eligibility. Specifically, we adopt rules

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characteristics and capital requirements of the particular service. 47 C F R § 1.2110(c)(1) In the *Part 1 Fifth Report and Order*, the Commission, in light of the *Adarand* decision, declined to adopt special provisions for minority- and women-owned businesses but noted that minority-and women-owned businesses that qualify as small businesses may take advantage of the provisions the Commission has adopted for small businesses. Amendment of Part 1 of the Commission's Rules—Competitive Bidding Procedures, WT Docket No. 97-82, *Order on Reconsideration of the Third Report and Order, Fifth Report and Order, and Fourth Further Notice of Proposed Rule Making*, 15 FCC Rcd 15293, 15319 ¶ 48 (2000) ("*Part 1 Fifth Report and Order*") (citing *Adarand Constructors, Inc v. Pena*, 515 U.S. 200, 227 (1995)). On several occasions, the Commission has declined to adopt bidding credits for large telephone companies that serve rural areas. *See, e g* , Implementation of Section 309(j) of the Communications Act—Competitive Bidding, PP Docket No. 93-253, *Fifth Memorandum Opinion and Order*, 10 FCC Rcd 403, 457-58, 462-63 ¶¶ 100, 111 (1994) ("*Competitive Bidding Fifth MO&O*"); Amendment of Part 1 of the Commission's Rules—Competitive Bidding Procedures, *Order on Reconsideration of the Third Report and Order, Fifth Report and Order, and Fourth Notice of Proposed Rule Making*, 15 FCC Rcd 15293, 15320-21 ¶¶ 51-52 (2000); Reallocation and Service Rules for the 698-746 MHz Spectrum Band (Television Channels 52-59), GN Docket No. 01-74, *Report and Order*, 17 FCC Rcd 1022, 1090-91 ¶ 176 (2002). The Commission determines eligibility for its small business provisions based on an entity's size determined pursuant to attribution rules. 47 C.F.R. § 1 2110(b)(1)-(3) *But see* Amendment of Part 1 of the Commission's Rules—Competitive Bidding Procedures, *Second Order on Reconsideration of the Third Report and Order and Order on Reconsideration of the Fifth Report and Order*, 18 FCC Rcd 10180, 10191-94 ¶¶ 16-18 (2003) (establishing exemption for rural telephone cooperatives from the requirement that gross revenues of entities controlled by an applicant's officers and directors be attributed to the applicant), *modified on reconsideration, Second Order on Reconsideration of the Fifth Report and Order*, 20 FCC Rcd 1942 (2005); 47 C F.R. § 1.2110(b)(3)(iii) (exempting rural telephone cooperatives from attributing the gross revenues of its officers and directors).

to limit the award of designated entity benefits, as explained in more detail below, to any applicant or licensee that has "impermissible material relationships" or an "attributable material relationship" created by certain agreements with one or more other entities for the lease or resale (including under a wholesale arrangement) of its spectrum capacity. These definitions of material relationships are necessary to strengthen our implementation of Congress's directives with regard to designated entities and to ensure that, in accordance with the intent of Congress, every recipient of our designated entity benefits is an entity that uses its licenses to directly provide facilities-based telecommunications services for the benefit of the public.[9]

4. We also adopt rule modifications to strengthen our unjust enrichment rules so as to better deter entities from attempting to circumvent our designated entity eligibility requirements and to recapture designated entity benefits when ineligible entities control designated entity licenses or exert impermissible influence over a designated entity.[10] Similarly, to ensure our continued ability to safeguard the award of designated entity benefits, we provide clarification regarding how the Commission will implement its rules concerning audits,

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[9] In the legislative history of Section 309(j), Congress explains that the reason for imposing anti-trafficking restrictions and unjust enrichment payment obligations on entities that receive small business benefits is to deter "participation in the licensing process by those who have no intention of offering service to the public." H.R. REP. NO. 103-111, at 257-58 (1993) (Conference Agreement adopted House provisions, in relevant part, with amendments. H.R. CONF. REP. NO. 103-213, at 483 (1993)).

[10] *See* 47 C.F.R. § 1.2111.

and we refine our rules with respect to the reporting obligations of designated entities.

5. The rules we adopt today will apply to all determinations of eligibility for all designated entity benefits, including bidding credits and, as applicable, set-asides[11] and installment payments, unless excepted by the grandfathering provisions described in detail below.[12] These rules will be applied to any application filed to participate in auctions in which bidding begins after the effective date of the rules adopted herein and to all long-form applications filed by winning bidders after such auctions,[13] as well as to all applications for an authorization, an assignment or transfer of control, a lease, or reports of events affecting a designated entity's ongoing eligibility,[14] including "impermissible material relationships" or "attributable material relationships," filed on or after release of this *Second Report and Order*. These rules will become effective thirty days after their publication in the Federal Register.

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[11] Broadband Personal Communications Services entrepreneurs will be subject to these new rules as described below.

[12] *See* discussion *infra* ¶¶ 28-30.

[13] The rules adopted herein, therefore, will not apply to the upcoming auction of 800 MHz Air-Ground Radiotelephone Service licenses, scheduled to begin on May 10, 2006, nor to the Form 601 applications to be filed subsequent to the close of that auction by the winning bidders. *See* Auction of 800 MHz Air-Ground Radiotelephone Service Licenses Scheduled for May 10, 2006; Notice and Filing Requirements, Minimum Opening Bids, Upfront Payments and Other Procedures for Auction No 65, *Public Notice*, 21 FCC Rcd 1278 (2006).

[14] *See* discussion *infra* note 116 and accompanying text.

B. *Second Further Notice of Proposed Rule Making*

6. In reviewing the record in this proceeding, including the requests of various parties to conduct a further inquiry,[15] we issue this *Second Further Notice* to consider whether we should adopt additional restrictions, beyond those we adopt herein, to further safeguard the benefits reserved for designated entities.[16]

II. BACKGROUND

7. Throughout the history of the auctions program, the Commission has endeavored to carry out its Congressional directive to promote the involvement of designated entities in the provision of spectrum-based services.[17] Congress recommended that the Commission, in assisting designated entities, consider the use of various mechanisms such as tax credits and bidding preferences.[18] Yet, in so doing, Congress also mandated that the Commission safeguard the award of the benefits it distributed to "prevent unjust enrichment as a result of the methods employed to issue licenses."[19]

8. The challenge for the Commission in carrying out Congress's plan has always been to find a reasonable balance between the competing goals of, first, providing designated entities with reasonable flexibility in being able to obtain needed financing from investors and, sec-

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[15] *See, e g* , Comments of NHMC at 17-18; Reply Comments of Consumers Union at 1-2.

[16] *See supra* note 8 (discussing the Commission's designated entity benefits)

[17] *See* 47 U.S.C. § 309(j)(4)(D), *see also* 47 C.F R. § 1.2110(a).

[18] 47 U S.C. § 309(j)(4)(D).

[19] *Id* § 309(j)(4)(E).

ond, ensuring that the rules effectively prevent entities ineligible for designated entity benefits from circumventing the intent of the rules by obtaining those benefits indirectly, through their investments in qualified businesses.[20] The changes in the Commission's designated entity rules over time have been the result of the Commission's continuing effort to maintain this balance effectively in the face of a rapidly evolving telecommunications industry, legislative changes, judicial decisions, and the demand of the public for greater access to wireless services.

9. The Commission's primary method of promoting the participation of designated entities in competitive bidding has been to award bidding credits—percentage discounts on winning bid amounts—to small business applicants.[21] The Commission also has utilized other incentives, such as installment payments and, in the broadband Personal Communications Services ("broadband PCS"), a license set-aside, to encourage designated entities to participate in spectrum auctions and in the provision of service.[22] In order to qualify for these benefits, an applicant must demonstrate that its gross revenues (and, in some cases, its total assets), in combination with those of its "attributable" interest holders, fall be-

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[20] *See* Implementation of Section 309(j) of the Communications Act—Competitive Bidding, PP Docket No. 93-253, *Fifth Report and Order*, 9 FCC Rcd 5532, 5582 ¶ 159 (1994) ("*Competitive Bidding Fifth Report and Order*").

[21] *See, e.g.*, Implementation of Section 309(j) of the Communications Act—Competitive Bidding, PP Docket No. 93-253, *Second Report and Order*, 9 FCC Rcd 2348, 2391-92 ¶¶ 241-44 (1994) ("*Competitive Bidding Second Report and Order*").

[22] *See id.* at 2389-91, 2392 ¶¶ 231-40, 245-48.

low certain service-specific financial caps.[23] Thus, in determining eligibility for size-based benefits, it is critical to decide which investors' gross revenues (and total assets) must be attributed.

10. During the early years of the designated entity program, the Commission adopted often complicated attribution rules on a service-specific basis. For broadband PCS attribution, the Commission had a "general rule"—its financial caps[24]—and four exceptions to the rule.[25] Two of these exceptions came to be known as the "control group exceptions"—a 25 percent equity exception and a 49.9 percent equity exception.[26] Both exceptions required the applicant to form a "control group"[27] within which "qualifying investors"[28] owned at least 50.1 percent of the applicant's voting interests.[29] Under the 25 percent equity exception, the applicant's control group was required to own at least 25 percent of the applicant's total equity; and, within the control group, qualifying investors were required to hold at least 15

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[23] *See* 47 C F.R. § 1.2110(b).

[24] *See id.* § 24.709(a)(1)-(2).

[25] *See id.* § 24 709(b)(1)(i)-(iv).

[26] *See id.* § 24.709(b)(1)(ii), (iv).

[27] A control group is an entity, or a group of individuals or entities, that possesses *de jure* and *de facto* control of an applicant or licensee. *See id.* § 24.720(k).

[28] A qualifying investor is a person who is (or holds an interest in) a member of the applicant's control group and whose gross revenues and total assets, when aggregated with those of all other attributable investors and affiliates, do not exceed the entrepreneurs' block gross revenues and total assets limits. *Id* § 24.720(n).

[29] *Id* § 24.709(b)(1)(v)(A)(2), (b)(1)(vi)(A)(2). If the applicant was a partnership, the control group was required to hold all of its general partnership interests *Id.*

percent of the applicant's total equity.[30] Under the 49.9 percent equity exception, the applicant's control group was required to own at least 50.1 percent of the applicant's total equity; and, within the control group, qualifying investors were required to hold at least 30 percent of the applicant's total equity.[31] If these and certain other requirements were met, the gross revenues and total assets of non-controlling investors were not attributed to the applicant.[32] These two exceptions to the general rule were widely used; however, the other two exceptions—one for publicly-traded corporations with widely dispersed voting stock ownership and the other for small business consortia[33]—were seldom invoked.

11. The Commission used the control group approach in broadband PCS for determinations of small business eligibility and also for determinations of "entrepreneur" eligibility. In broadband PCS, the Commission originally "set aside" C and F block licenses for "entrepreneurs,"[34] small entities whose gross revenues and total assets, when aggregated with those of their attributable interest holders, fell below certain financial

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[30] *Id.* § 24.709(b)(1)(v)(A), (b)(1)(v)(A)(1).

[31] *Id* § 24.709(b)(1)(vi)(A), (b)(1)(vi)(A)(1).

[32] *Id* § 24.709(b)(1)(iii)-(vi) The equity ownership requirements under both exceptions were somewhat relaxed for entities that had been operating and earning revenues for at least two years prior to December 31, 1994. *Id.* §§ 24 709 (b)(1)(v)(B), 24.709(b)(1)(vi)(B), 24.709(b)(6)(ii), 24.720(h).

[33] *See id.* § 24 709(b)(i), (ii).

[34] In some non-PCS services, the Commission uses the term "entrepreneur" to refer to a level of small business eligibility for bidding credits. *See, e g , id.* §§ 22.229, 27.702, 101.538, 101.1107, 101 1112, 101.1429.

caps.[35] A variation of this control group approach was employed for narrowband PCS.[36] In determining whether applicants for the 900 MHz specialized mobile radio ("SMR") service qualified as small businesses, the Commission attributed the revenues of parties holding partnership and other ownership interests and any stock interest amounting to 20 percent or more of the equity, or outstanding stock, or outstanding voting stock of the applicant.[37] For virtually all other services, the Commission used a "controlling interest"[38] or "controlling principal"[39] standard much like the attribution standard used today. Under this earlier standard, the Commission attributed to the applicant the gross revenues of its controlling interests and their affiliates in assessing whether the applicant was qualified to take advantage of

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[35] In the context of Broadband PCS, an applicant or licensee generally qualifies as an entrepreneur if it, together with its affiliates, persons or entities that hold interests in the applicant or licensee, and their affiliates, has combined total assets of less than $500 million and has had combined gross revenues of less than $125 million in each of the last two years. *Id.* § 24.709(a)(1).

[36] Under this standard, the gross revenues and affiliations of an investor in the applicant were not considered so long as the investor held 25 percent or less of the applicant's passive equity and was not a member of the applicant's control group. Amendment of Part 1 of the Commission's Rules—Competitive Bidding Proceeding, WT Docket 97-60, *Order, Memorandum Opinion and Order, and Notice of Proposed Rule Making*, 12 FCC Rcd 5686, 5702 ¶ 26 (1997) ("*Part 1 Order*")

[37] 47 C.F.R. § 90.814(g) (2001); *see Part 1 Order*, 12 FCC Rcd at 5703 ¶ 27.

[38] *See, e.g.*, 47 C.F.R. §§ 1.948, 1.2105, 1.2110, 1.2112, 20.6, 21.38, 22.223, 22.225.

[39] *See, e.g.*, *id.* §§ 1.2110, 22.223, 27.219, 90.814, 90.912, 90.1021, 101.1109.

the Commission's small business provisions, such as bidding credits.[40]

12. Since 2000, the Commission has applied the current "controlling interest" standard to all services when making attribution determinations.[41] Under this standard, the Commission attributes to an applicant the gross revenues of it, its controlling interests, its affiliates, and the affiliates of the applicant's controlling interests.[42] A "controlling interest" includes individuals or entities, or groups of individuals or entities, that have control of the applicant under the principles of either *de jure* or *de facto* control.[43] *De jure* control is typically evidenced by the holding of greater than 50 percent of the voting stock of a corporation or, in the case of a partnership, general partnership interests.[44] *De facto* control is determined on a case-by-case basis[45] and includes the criteria set forth in *Ellis Thompson*.[46] Under the

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[40] *See Part 1 Order*, 12 FCC Rcd at 5703 ¶ 27

[41] *See generally Part 1 Fifth Report and Order*, 15 FCC Rcd at 15293.

[42] *Id.* at 15323 ¶ 59.

[43] 47 C.F.R. § 1.2110(c)(2)

[44] *Id.*

[45] *Id.*

[46] In *Ellis Thompson*, the Commission identified the following factors used to determine control of a business: (1) use of facilities and equipment, (2) control of day-to-day operations, (3) control of policy decisions; (4) personnel responsibilities; (5) control of financial obligations; and (6) receipt of monies and profits Application of Ellis Thompson Corporation, *Memorandum Opinion and Order and Hearing Designation Order*, 9 FCC Rcd 7138, 7138-7139 ¶ 9 (1994) (citing the Commission's decision in *Intermountain Microwave*, Applications for Microwave Transfers to Teleprompter Approved with Warning, *Public Notice*, 12 FCC 2d 559 (1963) ("*Intermountain Microwave*") (1963)). *See also* Application of Baker Creek Communications, L.P. for Authority to

controlling interest standard, the officers and directors of any applicant are considered to have a controlling interest in the applicant.[47] The Commission has declined to impose minimum equity requirements on controlling interests, believing that such requirements would dictate that a person or entity identified as a controlling interest must retain some level of equity in the applicant, thereby reducing the amount of equity the applicant could offer to non-controlling interests in exchange for financing and making it more difficult for the applicant to attract sufficient investment to compete in the marketplace.[48]

13. In applying the controlling interest standard, the Commission's intent has been to provide designated entities with increased flexibility and simplicity in structuring their businesses, while continuing to ensure that size-based benefits are reserved solely for qualified entities. In making the change, the Commission acknowledged the complexity of the broadband PCS control group approach, emphasizing that the controlling interest standard would be "simpler" and "more straightforward to implement."[49] Also, the Commission explained, application of the controlling interest standard would

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Construct and Operate Local Multipoint Distribution Services in Multiple Basic Trading Areas, *Memorandum Opinion and Order*, 13 FCC Rcd 18709 (Wireless Tel. Bur. 1998) (discussing in detail the factors constituting *de facto* control); Stephen F. Sewell, *Assignments and Transfers of Control of FCC Authorizations Under Section 310(d) of the Communications Act of 1934*, 43 FED. COMM L.J. 277, 316-17 (1991).

[47] 47 C.F.R. 1.2110(c)(2)(ii)(F); *Part 1 Fifth Report and Order*, 15 FCC Rcd at 15325-26 ¶¶ 65-66

[48] *See Part 1 Fifth Report and Order*, 15 FCC Rcd at 15325-26 ¶ 65.

[49] *Id*

allow "legitimate small businesses . . . to attract passive financing in a highly competitive and evolving telecommunications marketplace,"[50] while ensuring "that only those entities truly meriting small business status qualif [ied] for [the Commission's] small business provisions."[51]

III. SECOND REPORT AND ORDER

A. Background

14. In the *Further Notice*, we tentatively concluded that we should restrict the award of designated entity benefits to an otherwise qualified applicant where it has a "material relationship" with a "large in-region incumbent wireless service provider."[52] We sought comment on how to define the specific elements of such a restriction.[53] Further, we sought comment on whether such a restriction on the award of designated entity benefits should apply where a designated entity applicant has a "material relationship" with a large entity that has a "significant interest in communication services," and whether we should include in such a definition a broad category of communications-related businesses or instead exclude or include certain types of entities.[54] In addition, we sought comment on whether we should

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[50] Amendment of Part 1 of the Commission's Rules—Competitive Bidding Procedures, WT Docket No 97-82, *Third Report and Order and Second Further Notice of Proposed Rule Making*, 13 FCC Rcd 374, 478 ¶ 186 (1997) ("*Part 1 Third Report and Order*").

[51] *Part 1 Fifth Report and Order*, 15 FCC Rcd at 15293, 15323-24 ¶ 58.

[52] *Further Notice*, 21 FCC Rcd at 1754-57 ¶¶ 1, 3-5.

[53] *Id.* at 1754-55, 1759-62 ¶¶ 1, 12-18.

[54] *Id.* at 1754-55, 1762-63 ¶¶ 1, 19.

adopt unjust enrichment provisions that would require reimbursement of designated entity benefits in the event that a designated entity makes a change in its material relationships or makes any other changes that would result in the loss of or change in its eligibility subsequent to acquiring a license with a designated entity benefit.[55] Finally, in the *Further Notice*, we sought comment on changes to the Commission's auction application rules to facilitate the application of any rule modifications to upcoming auctions.[56]

B. Material Relationship

15. As discussed fully below, we revise our Part 1 rules to consider certain relationships as factors in determining designated entity eligibility. In so doing, we seek to improve our ability to achieve Congress's directives with regard to designated entities and to ensure that, in accordance with the intent of Congress, every recipient of our designated entity benefits is an entity that uses its licenses to directly provide facilities-based telecommunications services for the benefit of the public.[57] Specifically, except as grandfathered below, an applicant or licensee has "impermissible material relationships" when it has agreements with one or more other

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[55] *Id.* at 1763 ¶ 20

[56] *Id.* at 1763-64 ¶ 21.

[57] In the legislative history of Section 309(j), Congress explains that the reason for imposing anti-trafficking restrictions and unjust enrichment payment obligations on entities that receive small business benefits is to deter "participation in the licensing process by those who have no intention of offering service to the public." H R. REP. NO. 103-111, at 257-58 (1993) (Conference Agreement adopted House provisions, in relevant part, with amendments. H R CONF. REP NO. 103-213, at 483 (1993)).

entities for the lease (under either spectrum manager or *de facto* transfer leasing arrangements) or resale (including under a wholesale arrangement) of, on a cumulative basis, more than 50 percent of its spectrum capacity of any individual license. Such "impermissible material relationships" render the applicant or licensee (i) ineligible for the award of designated entity benefits, and (ii) subject to unjust enrichment on a license-by-license basis. Furthermore, except as grandfathered below, an applicant or licensee has an "attributable material relationship" when it has one or more agreements with any individual entity, including entities and individuals attributable to that entity, for the lease (under either spectrum manager or *de facto* transfer leasing arrangements) or resale (including under a wholesale arrangement) of, on a cumulative basis, more than 25 percent of the spectrum capacity of any individual license that is held by the applicant or licensee. The "attributable material relationship" with that entity will be attributed to the applicant or licensee for the purposes of determining the applicant's or licensee's (i) eligibility for designated entity benefits, and (ii) liability for unjust enrichment on a license-by-license basis.

16. *Further Notice.* To define "material relationship," the *Further Notice* sought comment on the specific nature of the types of additional relationships that should trigger a restriction on the availability of designated entity benefits.[58] For instance, Council Tree initially proposed that the Commission should restrict a designated entity applicant's "material relationships," including both financial and operational agreements, in order to more carefully ensure that designated entity

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[58] *Further Notice*, 21 FCC Rcd at 1760 ¶ 13.

benefits are awarded only to bona fide eligible entities.[59] In this regard, we sought comment on what might constitute a "material financial" or "material operational" relationship. Moreover, insofar as our current rules already attribute the gross revenues of those that have relationships with designated entity applicants that confer either *de jure* and *de facto* control, we also sought comment on the type of attribution standard that we should apply to any rule modification.[60]

17. The *Further Notice* also sought comment on whether restricting certain agreements as a "material relationship" would be too harsh or unnecessarily limit a designated entity applicant's ability to gain access to capital or industry expertise.[61] Additionally, the *Further Notice* sought comment on whether there might be instances where the existence of either a "material financial agreement" or a "material operational agreement" might be appropriate and might not raise issues of undue influence.[62] In this regard, the *Further Notice* asked whether the Commission should allow designated entity applicants to obtain a bidding credit or other benefits if they had only a "material financial agreement" or only a "material operational agreement" but not both, and what factors we should consider in determining the types of relationships that might not adversely affect an applicant's designated entity eligibility.[63] Finally, we sought comment on whether a spectrum leasing arrangement should be defined as a "material relation-

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[59] *Id*

[60] *Id*

[61] *Id.* at 1761 ¶ 15.

[62] *Id.*

[63] *Id*

ship," and whether we should consider any other arrangements for the purposes of such a definition.[64]

18. *Comments.* Commenters are generally split regarding the level of specificity with which the Commission should define "material relationship." Several commenters urge the Commission to narrowly tailor the definition so as not to "inadvertently hinder the flow of capital" to designated entity applicants.[65] For example, Wirefree Partners argues that the Commission should "narrowly and specifically define what constitutes a material relationship" because "[s]mall businesses need the flexibility to enter into reasonable commercial agreements with other participants in the communications industry."[66] Others maintain that the reach of the Commission's policies should be very broad and that we should define "material relationship" to include both financial and operational agreements.[67] For example, Council

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[64] *Id.* at 1761 ¶ 16.

[65] *See, e.g.*, Comments of STX at 2; *see also* Comments of Antares at 4 ("the Commission needs to balance the public policy goal of continuing to encourage small business participation within the wireless industry against the very real need for qualified small businesses to raise capital in order to participate in wireless service auctions."); Comments of Cook Inlet at 3 ("it is particularly challenging for small companies to obtain access to financial resources necessary to support bidding and paying for even one license in a given auction, much less to construct and operate a system within the time frame mandated by the Commission's rules."); Comments of NAB at 2 ("If the Commission were to adopt unnecessarily restrictive DE rules, small businesses would be more limited in their ability to raise capital and attract investors."); Reply Comments of Ericsson at 2-3 (arguing that the Commission should not constrain access to manufacturer financing).

[66] Comments of Wirefree Partners at 7.

[67] *See, e g.*, Comments of Council Tree at 52; Comments of Leap at 15; Comments of MMTC at 2, 9.

Tree and other proponents of a broad definition maintain that the definition of material relationship should include, "without limitation, management agreements, trademark license agreements, joint marketing agreements, future interest agreements (such as puts, calls, options, and warrants), and long-term *de facto* and spectrum manager leasing arrangements."[68]

19. Rural service providers oppose the proposal to define "material relationship" in a manner that would preclude small businesses from entering into operational agreements with large wireless carriers.[69] As explained by one commenter, many small and rural wireless companies "have entered into management, marketing or other non-equity arrangements with large wireless carriers which enable them to provide quality wireless services to the rural areas they are licensed to serve."[70] Another commenter notes that "the Commission should not consider roaming agreements evidence of a 'material relationship' since to do so would eliminate almost every small rural carrier from enjoying DE status."[71]

20. In seeking comment on spectrum leasing, we asked "what, if any standard should be used to determine whether spectrum leasing is a material relationship for the purpose of any additional restriction on the

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[68] Comments of Council Tree at 52. *See also Further Notice*, 21 FCC Rcd at 1761 ¶ 9. A number of commenters also generally appeared to support the premise of Council Tree's proposals without specifically commenting on how the Commission might define "material relationship." *See, e.g.*, Comments of MobiPCS at 1, Comments of Suncom at 1, Comments of USCC at 2-3, 5.

[69] *See, e g* , Comments of NTCA at 7-8; Comments of RTG at 4-5

[70] Comments of John Staurulakis, Inc at 3.

[71] Comments of RTG at 5.

availability of designated entity benefits that we might adopt."[72] A few commenters argued that the Commission should not reverse the guidance provided in the *Secondary Markets* proceeding.[73] As noted above, a number of others generally agreed that the Commission should adopt Council Tree's proposal for material relationships, presumably including its suggestion that leasing should be included in the types of material relationships that should trigger a Commission restriction of the award of designated entity benefits.[74]

21. *Discussion.* In defining "material relationship," we seek to balance a designated entity applicant's need for flexibility to structure its business relationships against our statutory obligation to award these small business benefits only to entities intended by statute to be eligible. In our experience in administering the designated entity program over the last several years, we have witnessed a growing number of complex agreements between designated entities and those with whom they choose to enter into financial and operational relationships. Although some of these agreements may have contributed to the wireless industry becoming a thriving sector of the nation's economy, the relationships underpinning such contracts underscore the need for stricter regulatory parameters to ensure, as Congress intended, that: (1) benefits are awarded to provide opportunities for designated entities to become robust independent

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[72] *Further Notice*, 21 FCC Rcd at 1761 ¶ 16.

[73] *See, e.g.*, Comments of Wirefree Partners at 8-9; Comments of CTIA at 4.

[74] *See, e.g.*, Comments of Council Tree at 52; *see generally* Comments of MobiPCS at 1, Comments of Suncom at 1; Comments of USCC at 2-3, 5.

facilities-based service providers with the ability to provide new and innovative services to the public; and (2) the Commission employs methods to prevent unjust enrichment.[75]

22. We agree with commenters that certain agreements have the potential to significantly influence a designated entity licensee's decisions regarding its provision of service and, therefore, also have the potential to be abused, absent the appropriate safeguards. Yet, we also recognize the concerns of many, especially rural carriers, that argue that small businesses face practical difficulties in providing service and that stress that designated entity licensees must have the ability to enter into operational contracts, such as roaming, interconnection, and switch-sharing, with other, often large, providers in order to be in a position to provide valuable telecommunications service to the public.[76]

23. In considering how to evaluate which specific relationships should trigger additional eligibility restrictions, we conclude that certain agreements, by their very nature, are generally inconsistent with an applicant's or licensee's ability to achieve or maintain designated entity eligibility because they are inconsistent with Congress's legislative intent. In this regard, where an agreement concerns the actual use of the designated entity's spectrum capacity, it is the agreement, as op-

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[75] *See, e g.*, Comments of MMTC at 6 ("some of the largest national incumbent wireless carriers have received from their DE partners exclusive access to valuable spectrum and network capacity that otherwise could have been used to offer new services and induce the national wireless incumbents to better respond to the needs of the marketplace").

[76] *See, e g* , Comments of RTG at 5.

posed to the party with whom it is entered into, that causes the relationship to be ripe for abuse and creates the potential for the relationship to impede a designated entity's ability to become a facilities-based provider, as intended by Congress.

24. As we indicated in the *Secondary Markets Second Report and Order*, "Congress specifically intended that, in order to prevent unjust enrichment, the licensee receiving designated entity benefits actually provide facilities-based services as authorized by its license."[77] In that proceeding, the Commission stated that leasing by a designated entity licensee of "substantially all of the spectrum capacity of the licensee" would cause attribution that would likely lead to a loss of eligibility, and that the leasing of a "small portion" of such capacity where there was no other relationship between the parties likely would not result in a finding of attribution.[78] Although at least one commenter argues that the Commission's existing leasing rules provide adequate protection to ensure that the relationship between the parties "remains one of contract and not control,"[79] as articulated in the *Further Notice* and this decision, we are modifying our rules to include additional safeguards to our designated eligibility determinations that look beyond controlling relationships to those that have the

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[77] Promoting Efficient Use of Spectrum through Elimination of Barriers to the Development of Secondary Markets, WT Docket No. 00-230, *Second Report and Order, Order on Reconsideration, and Second Further Notice of Proposed Rulemaking*, 19 FCC Rcd 17503, 17538, 17541, 17544 ¶¶ 71, 76, 82 (2004) ("*Secondary Markets Second Report and Order*").

[78] *Id.* at 17541-42 ¶ 77.

[79] Comments of Wirefree Partners at 8.

potential to influence a designated entity in a manner contrary to that intended by Congress.

25. Building on our *Secondary Markets* policies and in consideration of the record we have before us, we modify our rules regarding eligibility for designated entity benefits for applicants or licensees that have agreements that create material relationships, as defined and explained herein. Specifically, except as grandfathered below,[80] we conclude that an applicant or licensee has "impermissible material relationships" when it has agreements with one or more other entities for the lease (under either spectrum manager or *de facto* transfer leasing arrangements) or resale (including under a wholesale arrangement) of, on a cumulative basis, more than 50 percent of its spectrum capacity of any individual license. Such "impermissible material relationships" render the applicant or licensee (i) ineligible for the award of designated entity benefits, and (ii) subject to unjust enrichment on a license-by-license basis. Furthermore, except as grandfathered below,[81] we find that an applicant or licensee has an "attributable material relationship" when it has one or more agreements with any individual entity, including entities and individuals attributable to that entity, for the lease (under either spectrum manager or *de facto* transfer leasing arrangements) or resale (including under a wholesale arrangement) of, on a cumulative basis, more than 25 percent of the spectrum capacity of any individual license that is held by the applicant or licensee.[82] The "attributable

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[80] *See* discussion *infra* ¶¶ 28-30.

[81] *See id.*

[82] If a designated entity licensee disaggregates its license, determinations of impermissible and attributable material relationships will be

material relationship" with that entity will be attributed to the applicant or licensee for the purposes of determining the applicant's or licensee's (i) eligibility for designated entity benefits, and (ii) liability for unjust enrichment on a license-by-license basis.[83]

26. As stated above, our experience in administering the designated entity program and our review of the record developed in response to our *Further Notice* leads us to conclude that these definitions of material relationship are necessary to ensure that the recipient of our designated entity benefits is an entity that uses its licenses to directly provide facilities-based telecommunications services for the benefit of the public; that the Commission employs methods to prevent unjust enrichment; and that our statutory-based benefits are

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made based upon its remaining spectrum license. For example, if a designated entity licensee disaggregates 5 MHz of a 10 MHz license, it cannot have spectrum leasing or resale arrangements for more than 2.5 MHz of spectrum, pursuant to the "impermissible material relationships" restriction, and any spectrum leasing or resale arrangements with one individual entity for more than 1.25 MHz of spectrum will result in the attribution of revenues and assets, pursuant to the "attributable material relationships" restriction.

[83] During the first five years of the license term, broadband PCS entrepreneurs that have not yet met their five-year construction requirements will be prohibited from entering into any impermissible material relationships with entities of any size. They will also be prohibited from entering into attributable material relationships if those relationships bring their attributable gross revenues or total assets above the financial caps established in section 24.709. After build-out or the first five years of the license term, broadband PCS entrepreneurs that are participating in the installment payment plan and enter into impermissible or attributable material relationships will be subject to installment payment unjust enrichment pursuant to section 1.2111(c). *See* 47 C.F.R. §§ 1.2110, 1.2111, 24.709, 24.839.

awarded only to those that Congress intended to receive them.

27. Spectrum manager and *de facto* transfer leasing agreements and resale agreements (including wholesale arrangements) with a single entity for 25 percent and less of the designated entity licensee's total spectrum capacity on a license-by-license basis, or cumulative agreements with multiple entities for 50 percent or less of a designated entity licensee's total spectrum capacity on a license-by-license basis will continue to be reviewed under our existing designated entity eligibility rules and, pursuant to existing rules and policies, may result in unjust enrichment obligations.[84] Through the decisions we make today, we will ensure that a designated entity licensee will preserve at least half of its spectrum capacity of each of its licenses for which it has been awarded and retained designated entity benefits for the provision of service as a facilities-based provider for the benefit of the public, while still having flexibility to engage in agreements that are intended to provide it with access to valuable capital, thus better furthering the goals of the statutory designated entity program.

28. *Grandfathering and Applicability of Material Relationships.* Recognizing that there are numerous agreements in existence that might fall within our newly defined "impermissible material relationships" and "attributable material relationship," we will apply these eligibility restrictions on a prospective basis. Therefore, we will not employ our new restrictions to reconsider any designated entity benefits previously awarded to

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[84] *See Secondary Markets Second Report and Order*, 19 FCC Rcd at 17538, 17541, 17544 ¶¶ 71, 76, 82.

licensees prior to the release date of this *Second Report and Order* or to determine designated entity benefits in an application for a license, an authorization, or an assignment or transfer of control or a spectrum lease that was filed with the Commission before the release date of this *Second Report and Order* that is still pending approval. Accordingly, we will grandfather the existence of impermissible and attributable material relationships that were in existence before the release date of this *Second Report and Order* for the purposes of assessing unjust enrichment payments on benefits previously awarded or pending award, as discussed above. In assessing the imposition of unjust enrichment for future events, if any, we will consider unjust enrichment implications on a license-by-license basis.

29. Such relationships, are not, however, generally grandfathered for the purposes of determining an applicant's eligibility for the award of designated entity benefits in future auctions or for the purposes of determining eligibility for benefits in the context of an assignment, transfer of control, spectrum lease or reportable eligibility event after the release date of this *Second Report and Order*. Except as limited by our grandfathering provisions, the rules we adopt today will apply to all determinations of eligibility for all designated entity benefits with regard to any application filed to participate in auctions in which bidding begins after the effective date of the rules, as well as to all applications for an authorization, an assignment or transfer of control, a spectrum lease, or reports of events affecting a designated entity's ongoing eligibility filed on or after the release date of

this *Second Report and Order*.[85] Grandfathering the eligibility of all prior designated entity structures that involve impermissible and/or attributable material relationships would allow these designated entities to continue to acquire additional licenses and designated entity benefits using a structure that the Commission has determined would permit a third party to leverage improper influence over a designated entity in a manner that is inconsistent with the Congressional purposes for the designated entity program. Applying our rules in this manner is consistent with how the Commission currently determines an applicant's eligibility for designated entity benefits and how it applies its unjust enrichment obligations.

30. To address concerns of several commenters, we will, however, grandfather certain relationships that were in existence before the release date of this *Second Report and Order* in the context of eligibility for future benefits. Specifically, an applicant will not be considered to be ineligible for benefits based solely on an "attributable material relationship" or "impermissible material relationships" of certain of its affiliates (as specifically defined in section 1.2110(c)(5)(i)(C)), provided that the

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[85] For example, if an applicant seeking to participate in an upcoming auction has an existing impermissible material relationship on a single license, it will be ineligible for the award of designated entity benefits in that auction, regardless of the significance of that one license in terms of the applicant's revenue or the scope of its operations. This is true even if the impermissible material relationship was entered into prior to the release of this order and thus grandfathered for purposes of unjust enrichment. Similarly, if it is an attributable material relationship at issue, then the gross revenues of the entity with which the applicant has such a relationship are counted against the applicant and may affect its eligibility.

agreement that forms the basis of the affiliate's "attributable material relationship" or " impermissible material relationship" is otherwise in compliance with the Commission's designated entity eligibility rules, was entered into prior to the release date of this *Second Report and Order*, and is subject to a contractual prohibition that prevents the affiliate from contributing to the designated entity's total financing. The purpose of this grandfathering is to provide a means for controlling interests of existing designated entities to have an ability to seek the award of designated entity benefits in future auctions or to acquire designated entity licenses in the secondary market through new and independent affiliates, even if it is affiliated with an existing designated entity that has impermissible and/or attributable material relationships that were in existence prior to the release date of the decision.[86] The attribution rules are not affected by this grandfathering.[87] In taking this action,

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[86] For example, Newco is an applicant seeking designated entity status in an auction in which bidding begins after the effective date of the rules. Investor is a controlling interest of Newco. Investor also is a controlling interest of Existing DE. Existing DE previously was awarded designated entity benefits and has impermissible material relationships based on leasing agreements entered into before the release date of this order with a third party, Lessee, that were in compliance with the Commission's eligibility standards prior to the effective date of the rules adopted herein. In this example, Newco would not be prohibited from acquiring designated entity benefits solely because of the existing impermissible material relationships of its affiliate, Existing DE. Newco, Investor, and Existing DE, however, would need to enter into a contractual prohibition that prevents Existing DE from contributing to the total financing of Newco.

[87] *See* 47 C.F.R. § 1.2110(b). Under the example in the preceding note, Newco would have to attribute the gross revenues of its affiliate, Existing DE, in establishing eligibility for designated entity benefits, but would not have to attribute the gross revenue of Lessee.

we seek to ensure that the additional eligibility requirements we adopt today do not unnecessarily restrict applicants seeking designated entity benefits for relationships that were previously permissible under our rules.

C. Unjust Enrichment

31. We also make changes to our unjust enrichment rules to provide additional safeguards designed to better ensure that designated entity benefits go to their intended beneficiaries.[88] As discussed below, one of our primary objectives in administering our designated entity program is to prevent unjust enrichment.[89] Accordingly, in conjunction with the eligibility restrictions we adopt above, we also modify our rules and strengthen our unjust enrichment schedule for licenses acquired with bidding credits.

32. *Further Notice.* In the *Further Notice*, we sought comment on whether we should adopt revisions to our unjust enrichment rules, as proposed by Council Tree,[90] or whether we should adopt other revisions to our unjust enrichment rules.[91] The Commission also asked whether reimbursement obligations should apply

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[88] *See id.* § 1.2111(b)-(e)

[89] *See* 47 U.S.C. § 309(j)(4)(E); *see also id* § 309(j)(3)(C)

[90] Council Tree suggested a reimbursement obligation on a licensee that acquires a license with a bidding credit and subsequently, in the first five years of its license term, makes a change in its "material relationships" that would result in its loss of eligibility for the bidding credit, or seeks to assign or transfer control of the license to an entity that would not qualify for the same level of bidding credits, pursuant to any eligibility restriction that we adopt. *Further Notice*, 21 FCC Rcd at 1763 ¶ 20; Council Tree Proposal at 15

[91] *Further Notice*, 21 FCC Rcd at 1763 ¶ 20.

if a licensee takes on new investment, or also where it enters into any new financial or operational relationship that would render the licensee ineligible for a bidding credit.[92] Pursuant to any eligibility restriction that we might adopt, we asked over what portion of the license term such unjust enrichment provisions should apply.[93]

33. Additionally, we sought comment in the *Further Notice* on Council Tree's proposal that an unjust enrichment payment should not be required in the case of "natural growth" of the revenues attributed to an incumbent carrier above the established benchmark.[94] Instead, Council Tree suggests that the reimbursement obligation should apply only where the licensee takes on new investment, or enters into any operational agreement, that would have disqualified the licensee for the bidding credit at the time of the licensee's initial application.[95]

34. *Comments.* Of the commenters discussing proposed changes in the unjust enrichment policies, some contend that the Commission should continue to apply the current unjust enrichment standard.[96] These entities argue that the current unjust enrichment rules are sufficient and provide adequate protection. Thus, they

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[92] *Id.*

[93] *Id.*

[94] *Id.*

[95] *Id* ; Council Tree Proposal at 16.

[96] *See, e g* , Comments of Aloha Partners at 5; Comments of Carroll Wireless at 8; Comments of Wirefree Partners at 14-15, Comments of Council Tree at 59.

conclude that no increased regulation is needed or appropriate.[97]

35. Other commenters argue for the implementation of stricter unjust enrichment rules.[98] STX supports "stricter unjust enrichment rules so that the U.S. Treasury may be made whole in the event that a designated entity turns out to have been merely a front organized to secure bidding credits for a large incumbent wireless service provider."[99] MMTC suggests that the Commission should consider adjusting its reimbursement obligations to require 100 percent of the value of the bidding credit.[100] MMTC further suggests that "the Commission should consider expanding the unjust enrichment standard to encompass the entire license term and not just the first five years."[101]

36. *Discussion.* We agree with MMTC and STX that adoption of stricter unjust enrichment rules, applicable to all designated entities, will promote the objectives of the designated entity program. The designated entity and unjust enrichment rules were adopted to ensure the creation of new telecommunications businesses owned by small businesses that will continue to provide spectrum-based services.[102] In addition, the unjust enrichment rules provide a deterrent to speculation and

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[97] *See, e.g.*, Comments of Aloha at 5; Comments of Carroll Wireless at 8.

[98] *See, e.g.*, Comments of STX at 2, Comments of U.S. Wirefree at 4, Comments of MMTC at 15; Comments of Council Tree at 15-16.

[99] Comments of STX at 2.

[100] Comments of MMTC at 15.

[101] *Id.*

[102] *Competitive Bidding Second Report and Order*, 9 FCC Rcd at 2394 ¶ 258.

participation in the licensing process by those who do not intend to offer service to the public, or who intend to use bidding credits to obtain a license at a discount and later to sell it at the full market price for a windfall profit.[103] By extending the unjust enrichment period to ten years, we increase the probability that the designated entity will develop to be a competitive facilities-based service provider.

37. We adopt the following ten-year unjust enrichment schedule for licenses acquired with bidding credits. For the first five years of the license term, if a designated entity loses its eligibility for a bidding credit for any reason,[104] including but not limited to, entering into an "impermissible material relationship" or an "attributable material relationship," seeking to assign or transfer control of a license, or entering into a *de facto* transfer lease with an entity that does not qualify for bidding credits, 100 percent of the bidding credit, plus interest, is owed. For years six and seven of the license term, 75 percent of the bidding credit, plus interest, is owed. For years eight and nine, 50 percent of the bidding credit, plus interest, is owed, and for year ten, 25 percent of the bidding credit, plus interest, is owed. If a designated entity loses its eligibility for the same level of bidding credit that it originally received for any reason,[105] including but not limited to, entering into an "impermis-

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[103] *Id.* at 2385, 2394 ¶¶ 211, 259. *See also* H.R. REP. NO. 103-111, at 257-58 (1993) (Conference Agreement adopted House provisions, in relevant part, with amendments. H.R. CONF REP. NO. 103-213, at 483 (1993)); *Secondary Markets Second Report and Order*, 19 FCC Rcd at 17538 ¶ 71

[104] *See* discussion *infra* note 116 and accompanying text.

[105] *See* discussion *infra* note 116 and accompanying text.

sible material relationship" or an "attributable material relationship," seeking to assign or transfer control of a license, or entering into a *de facto* transfer lease with an entity that does not qualify for the same level of bidding credits, this unjust enrichment schedule will be applied to the difference between the original bidding credit and the bidding credit for which the designated entity, assignee, or assignor is eligible.[106]

38. In addition to revising the unjust enrichment payment schedule, we will impose a requirement that the Commission must be reimbursed for the entire bidding credit amount owed, plus interest, if a designated entity loses its eligibility for a bidding credit for any reason,[107] including but not limited to, entering into an "impermissible material relationship" or an "attributable material relationship," seeking to assign or transfer control of a license, or entering into a *de facto* transfer lease with an entity that is not eligible for bidding credits prior to the filing of the notification informing the Commission that the construction requirements applicable at the end of the license term have been met.[108]

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[106] We also note that the provisions of section 1.2112(c) of the Commission's rules may also apply 47 C.F.R. § 1.2112(c) (discussing the assessment of unjust enrichment in the context of the partition and/or disaggregation of licenses).

[107] *See id.*

[108] Licensees may, under section 1.946(c) of our rules, request an extension of time to meet the applicable construction requirements. 47 C.F.R. § 1.946(c). Additionally, licensees may also request a waiver of the construction requirement, and this request must meet the requirements of section 1.925 of our rules. 47 C.F.R. § 1.925. We note that we will undertake careful scrutiny of requests for extension of the construction requirements filed by designated entities consistent with our rules, obligations under the Communications Act, and legal precedent,

For example, if a designated entity seeks to assign a license with a bidding credit to an entity that is not eligible for bidding credits eight years after the grant of the license and prior to the filing of the construction notification, 100 percent of the bidding credit, plus interest, will be owed, rather than the 50 percent unjust enrichment payment that would have been due had the construction notification been on file with the Commission, pursuant to the revised unjust enrichment schedule, above.

39. We impose the above-mentioned reimbursement obligations on any licensee that acquires licenses with bidding credits and subsequently loses its eligibility for a bidding credit for any reason because the implementation of such a policy is consistent with the policies underlying the Commission's designated entity and unjust enrichment requirements. By expanding the unjust enrichment period and requiring full payment of the bidding credit until a license has been constructed, we are fulfilling Congress's mandate that designated entities are given the opportunity to participate in the provision of spectrum-based services, while ensuring that entities that are not eligible for designated entity benefits cannot benefit from the designated entity program by acquiring the licenses or entering into impermissible or attributable material relationships with a designated

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and that we will consider, as part of our review, whether the extension request is an effort to defeat the objectives of our designated entity program. If a designated entity is successful in obtaining an extension of the construction requirements beyond the initial license term, the requirement that the Commission must be reimbursed for the entire bidding credit amount, plus interest, prior to the filing of the notification informing the Commission that the applicable construction requirements will continue to apply until such notifications are filed.

entity after it acquires a license at auction or in the secondary market.[109]

40. We agree with Council Tree's proposal that unjust enrichment payments should not be required for licenses held by the designated entity in the case of "natural" or "permissible" growth of the gross revenues of either a designated entity or an investor in a designated entity. Currently, there are no permissible growth provisions associated with bidding credits.[110] However, Commission practice has been that a designated entity will not owe unjust enrichment for its licenses if the designated entity's increased gross revenues, or the increased gross revenues of any controlling interest or affiliate, are due to nonattributable equity investments, debt financing, revenue from operations or other investments, business development, or expanded service.[111] Commission precedent states that the Commission evaluates an applicant's or licensee's eligibility for designated entity benefits and determines whether unjust enrichment is owed at the time the relevant application or notification (*e.g.*, transfer of control or assignment) is

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[109] *See* 47 U.S.C. § 309(j)(4)(E); *see also* id. § 309(j)(3)(C).

[110] We note that, although the Commission did not adopt a permissible growth exception for bidding credit unjust enrichment, it did adopt a permissible growth exception for set-aside, or closed bidding, licenses and installment payments. *Compare* 47 C.F.R. § 1.2111(d) *with id.* §§ 1.2111(c)(2), *and id.* § 24.709(a)(2).

[111] *Cf.* 47 C.F.R. § 1.2111(c)(2) (establishing that "permissible growth" does not result in unjust enrichment in the context of installment payments); *id.* § 24.709(a)(2) (establishing that permissible growth does not result in the loss of eligibility to hold set-aside, or closed bidding, licenses).

filed.[112] Under the policies adopted in this *Second Report and Order*, the Commission similarly would evaluate an applicant's or licensee's eligibility for designated entity benefit at the time it files an application regarding a reportable eligibility event, as required in the new section 1.2114 that we adopt herein. Thus, if the designated entity seeks to acquire licenses on the secondary market or in future auctions, all of the designated entity's gross revenues, along with the gross revenues of its controlling interests and affiliates, will be attributed to the designated entity.[113]

41. Finally, we agree with Cook Inlet's general concern that retroactive penalties not be imposed upon preexisting designated entities. Thus, as discussed fully above, we grandfather the applicability of these rules under certain circumstances.[114]

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[112] *See* Applications of TeleCorp PCS, Inc., Tritel, Inc, and Indus, Inc , WT Docket No. 00-1589, *Memorandum Opinion and Order*, 16 FCC Rcd 3716, 3737 ¶ 49 (Wireless Tele. Bur. 2000) ("*TeleCorp-Tritel Order*"); D&E Communications, Inc., *Order*, 15 FCC Rcd 61, 67 ¶ 12 (Auctions & Ind Analysis Div., Wireless Tele. Bur. 1999) ("*D&E Communications*").

[113] *See* Amendment of Commission's Rules Regarding Installment Payment Financing for Personal Communications Services (PCS) Licenses, WT Docket No. 97-8200-1589, *Memorandum Opinion and Order*, 14 FCC Rcd 20543, 20545-46 ¶¶ 6-8 (1999); *see also TeleCorp-Tritel Order*, 16 FCC Rcd at 3734 ¶ 46; *D&E Communications*, 15 FCC Rcd at 67 ¶ 12.

[114] *See* discussion *supra* ¶¶ 28-30 (discussing the grandfathering of impermissible and attributable material relationships that were in existence before the release date of this *Second Report and Order* for the purposes of assessing unjust enrichment penalties on benefits previously awarded).

D. Implementation

42. In this section, we explain how we intend to utilize the tools for preventing abuse of the designated entity program that are already at our disposal in our rules, and we describe certain minor rule modifications that we adopt in order to make these tools more effective. To achieve this purpose, we will use the following combination of existing and new measures to ensure that designated entity incentives benefit solely those parties intended to receive them under both our rules and section 309(j) of the Communications Act of 1934, as amended ("Communications Act"). First, we will review the agreements to which designated entity applicants and licensees are parties. Second, we will require that applicants and licensees seek advance Commission approval for all events that might affect their ongoing eligibility for designated entity benefits. Third, we will impose periodic reporting requirements on designated entities. Fourth, we will conduct audits, including random audits, of those claiming designated entity benefits. In this section we also provide guidance as to how our rules and procedures should be followed by applicants for the upcoming Advanced Wireless Services ("AWS") auction.

43. *Review of Agreements.* In applying our controlling interest standard, Commission staff has carefully reviewed agreements between applicants claiming designated entity status and other existing wireless carriers. In these cases, staff has usually undertaken discussions with such designated entity applicants in order to obtain revisions to agreements to ensure that entities with whom they have partnered are not an attributable controlling interest or affiliate obviating the applicant's

eligibility for designated entity benefits. This review is necessarily specific to each relationship, since no two sets of agreements and no two sets of factual circumstances are exactly the same.

44. In light of the steps we are taking in this *Second Report and Order* to aid our ability to ensure that only eligible entities obtain designated entity benefits, we will undertake a thorough review of the long-form application (FCC Form 601) filed by every winning bidder claiming designated entity benefits and will carefully review all relevant contracts, agreements, letters of intent, and other such documents affecting that applicant. This review remains essential to our assessment of designated entity eligibility under the controlling interest standard and will be even more critical in ensuring that the rules and policies adopted in this *Second Report and Order* are fully effectuated. Thus, we will require that all designated entity applicants that are winning bidders at an auction file all relevant contracts, agreements, letters of intent, and other such documents affecting that applicant as part of the long-form application (FCC Form 601). In order to implement this rule, we delegate to the Bureau the authority to determine the method for designated entities to submit the appropriate and relevant documents. We note, however, that no licenses will be granted until all relevant contracts, agreements, letters of intent, and other such documents affecting that applicant are finalized.

45. Further, we will also thoroughly review all relevant contracts, agreements, letters of intent, and other such documents affecting an applicant, which claims designated entity eligibility, seeking to acquire licenses with designated entity benefits in the secondary market

(*e.g.*, transfers of control, assignments, spectrum manager leases). Commission staff has requested such documents from entities acquiring designated entity licenses in the secondary market, especially when the applicant is a newly-created entity that has not been passed on as a designated entity in the past or where it appears that the corporate structure of a designated entity has changed. Thus, we will, as we have in the past, request designated entity applicants to forward copies of their agreements to Commission staff for review.

46. *Event-Based and Annual Reporting Requirements.* In light of the changes that we are making to the designated entity rules, the Commission will require additional information from applicants and licensees in order to ensure compliance with the policies and rules adopted herein. We also hereby adopt rules as shown in Appendix B, authorizing modifications to be made, as necessary, to and the creation, if necessary, of FCC forms to implement the rule changes adopted herein. Although many of these rule changes are minor, we highlight the following changes to our rules. Specifically, we adopt a new rule, section 1.2114, to require that designated entities seek approval[115] for any event in which they are involved that might affect their ongoing eligibility,[116] even if the event would not have triggered a re-

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[115] Obtaining prior approval for events that could possible effect an entity's designated entity eligibility is consistent with our practices for reviewing applications for the assignment or transfer of control of designated entity licenses. *See* 47 C.F.R. § 1.948(c)(1)(i).

[116] Such events include changes in the ownership structure of the designated entity and agreements (*e.g.*, management, credit, trademark, marketing, and facilities agreements) entered into between designated entity licensees and third parties that the Commission has not previously reviewed. New section 1.2114(c) provides that such filings

porting requirement under our rules.[117] Such events—known as "reportable eligibility events"—will also include those that result in an "impermissible material relationship" or an "attributable material relationship." We note that applications seeking approval of these "reportable eligibility events" will be considered substantial (*i.e.*, not *pro forma*) pursuant to the Commission's rules or precedent and will not be approved until any applicable unjust enrichment is paid.

47. Additionally, we will revise section 1.2110 of the Commission's rule to require designated entity licensees to file an annual report with the Commission, which will, at a minimum, include a list and summaries of all agreements and arrangements (including proposed agreements and arrangements) that relate to eligibility for designated entity benefits. In addition to a summary of each agreement or arrangement, this list must include the parties (including affiliates, controlling interests, and affiliates of controlling interests) to each agreement or arrangement, as well as the dates on which the parties entered into each agreement or arrangement. Annual reports will be filed no later than, and up to five business days before, the anniversary of the designated entity's license grant.[118]

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will be treated as if they are transfer of control applications under section 1.1102 for purposes of determining the appropriate application fees

[117] 47 C.F.R. § 1.948(j).

[118] The record supports such an approach. *See, e.g.* Comments of Cook Inlet at 21 (suggesting that the Commission require each designated entity to submit an annual report detailing the actions it took during the past period with respect to the licenses it holds as well as any actions taken by its limited financial partners. It believes that the Commission would have some empirical evidence of the degree of day-to-day

48. We consider adoption of these reporting requirements to be a foreseeable component of the designated entity eligibility rules we adopt today, and we believe them to be necessary to the successful implementation of these rules. We also consider these requirements to be an extension of the existing responsibility of designated entities to retain and make available, on an ongoing basis, all agreements related to their eligibility.[119] Furthermore, we delegate to the Bureau the authority to implement the necessary modifications to FCC forms and the Universal Licensing System (ULS) to implement these rule changes and to determine the content of, and filing procedures for, the new annual filing requirement.

49. *Audits.* Pursuant to our existing rules, the Commission has broad power to conduct audits at any time and for any reason, including at random, of applicants and licensees claiming designated entity benefits.[120] In its comments, MMTC urges the Commission to employ its existing audit power and regularly conduct random audits to "uncover manipulation of the [designated entity] program irrespective of the type of business in which a [designated entity] applicant's partner is engaged."[121] MMTC recommends that these audits "incorporate site visits to offices and physical plants, interviews with staff and meaningful inquiries into the management of the licenses," explaining that these efforts would be "more likely to yield discoveries of improper

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control actually exercised by the parties who purport to be in *de facto* control of these designated entity licensees).

[119] *See* 47 C.F.R. § 1.2110(j).

[120] *See id.* § 1.2110(j), (n)

[121] Comments of MMTC at 13-14

activity than cursory paper-base[d] audits which would allow the audited entity to craft creative responses to audit requests."[122] Cook Inlet, in suggesting the imposition of periodic reporting requirements, noted above, explains that such requirements, along with "the possibility of a further audit [,] might dissuade some abuse of the Commission's rules. . . . "[123]

50. We agree that our audit authority is an effective method by which to ascertain the initial and ongoing eligibility of the claimants of designated entity benefits. Applicants and licensees should therefore understand that the Commission can and will audit their continued designated entity eligibility as circumstances may necessitate or at will. Moreover, based on the significance of the upcoming AWS auction, we commit to audit the eligibility of every designated entity that wins a license in that auction at least once during the initial license term. In order to effectively conduct these audits, we delegate to the Bureau the authority to implement and create procedures to perform such audits.

51. *Pending Auction Provisions.* As noted in the *Further Notice*, we intend any changes adopted in this proceeding to apply to AWS licenses currently scheduled to be offered in an auction beginning June 29, 2006.[124] We noted that in light of the current auction schedule, any changes that we adopt in this proceeding may become effective after the deadline for filing appli-

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[122] *Id.* at 14.

[123] Comments of Cook Inlet at 21.

[124] Auction of Advanced Wireless Services Licenses Scheduled for June 29, 2006, Comment Sought on Reserve Prices or Minimum Opening Bids and Other Procedures, AU Docket No. 06-30, *Public Notice*, 21 FCC Rcd 794 (2006).

cations to participate in that auction. We sought comment on our proposal to require applicants to amend their applications on or after the effective date of the rule changes with a statement declaring, under penalty of perjury, that the applicant is qualified as a designated entity pursuant to section 1.2110 of the Commission's rules effective as of the date of the statement.[125] We also noted that in the event applicants fail to file such a statement pursuant to procedures announced by public notice, they will be ineligible to qualify as a designated entity.[126]

52. The vast majority of commenters did not address this issue.[127] Under Commission rules, applicants asserting designated entity eligibility in a Commission

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[125] *Cf* 47 C.F.R. 1.2105(a)(2)(iv) (parallel statement currently required as of the date of filing the short-form application). Pursuant to its delegated authority to conduct auctions, the Wireless Telecommunications Bureau will establish any detailed procedures necessary for making required amendments and announce such procedures by public notice. *See id.* §§ 0 131, 0 331.

[126] As noted in the *Further Notice*, while prior certifications may be a prerequisite to eligibility, applicants still must demonstrate compliance with all applicable Commission rules, including eligibility for any bidding credits, at the time the Commission is ready to grant a license, regardless of previously applicable rules. *See* Implementation of the Commercial Spectrum Enhancement Act and Modernization of the Commission's Competitive Bidding Rules and Procedures, *Report and Order*, 21 FCC Rcd 891, 909 n.84 (2006); *see also Celtronix Telemetry, Inc. v. FCC*, 272 F 3d 585, 587 (D.C. Cir. 2001), *cert denied*, 536 U.S. 923 (2002) (affirming Commission application of installment payment rules that were revised after initial grant of license).

[127] While CTIA expresses some concern regarding the amendment of short form applications, the public interest benefits associated with requiring entities to amend their applications and certify that they are qualified as a designated entity pursuant to our modified rules, outweigh any concerns raised in the record.

auction are required to declare, under penalty of perjury, that they are qualified as a designated entity under section 1.2110 of the Commission's rules.[128] After reviewing the record and considering the public interest benefits associated with our proposal, we will require entities applying as designated entities to amend their applications for the AWS auction on or after the effective date of the rule changes with a statement declaring, under penalty of perjury, that the applicant is qualified as a designated entity pursuant to section 1.2110 of the Commission's rules effective as of the date of the statement.

IV. SECOND FURTHER NOTICE OF PROPOSED RULE MAKING

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V. CONCLUSION

93. For all of the reasons set forth above, we modify our rules for determining the eligibility of applicants for size-based benefits in the context of competitive bidding and issue a *Second Notice of Proposed Rule Making* to consider whether we should adopt additional restrictions to further safeguard the benefits reserved for designated entities.

VI. PROCEDURAL MATTERS

A. Regulatory Flexibility Analyses

94. As required by the Regulatory Flexibility Act, *see* 5 U.S.C. § 604, the Commission has prepared a Final

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[128] *See* 47 C.F.R. § 1.2105(a)(2)(iv).

Regulatory Flexibility Analysis, set forth below at Appendix C.

95. An Initial Regulatory Flexibility Analysis ("IRFA") for the *Second Further Notice* is attached at Appendix D.[129] Comments on the IRFA should be labeled as IRFA Comments, and should be submitted pursuant to the filing dates and procedures set forth below.

B. Comment Filing Procedures

96. Pursuant to sections 1.415 and 1.419 of the Commission's rules, 47 C.F.R §§ 1.415, 1.419, interested parties may file comments on or before 60 days after publication in the Federal Register and may file reply comments on or before 90 days after publication in the Federal Register. All filings related to this Second Further Notice of Proposed Rule Making should refer to WT Docket No. 05-211. Comments may be filed using: (1) the Commission's Electronic Comment Filing System (ECFS), (2) the Federal Government's eRulemaking Portal, or (3) by filing paper copies. *See* Electronic Filing of Documents in Rule Making Proceedings, 63 FR 24121 (1998).

97. Electronic Filers: Comments may be filed electronically using the Internet by accessing the ECFS: http://www.fcc.gov/cgb/ecfs/ or the Federal eRulemaking Portal: http://www.regulations.gov. Filers should follow the instructions provided on the website for submitting comments. For ECFS filers, if multiple docket or rule making numbers appear in the caption of this proceeding, filers must transmit one electronic copy of the comments for each docket or rule making number

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[129] *See* 5 U.S.C. § 603.

referenced in the caption. In completing the transmittal screen, filers should include their full name, U.S. Postal Service mailing address, and the applicable docket or rule making number. Parties may also submit an electronic comment by Internet e-mail. To get filing instructions, filers should send an e-mail to ecfs@fcc.gov, and include the following words in the body of the message, "get form." A sample form and directions will be sent in response.

98. Paper Filers: Parties who choose to file by paper must file an original and four copies of each filing. Filings can be sent by hand or messenger delivery, by commercial overnight courier, or by first-class or overnight U.S. Postal Service mail (although we continue to experience delays in receiving U.S. Postal Service mail). All filings must be addressed to the Commission's Secretary, Office of the Secretary, Federal Communications Commission.

- The Commission's contractor will receive hand-delivered or messenger-delivered paper filings for the Commission's Secretary at 236 Massachusetts Avenue, N.E., Suite 110, Washington, DC 20002. The filing hours at this location are 8:00 a.m. to 7:00 p.m. All hand deliveries must be held together with rubber bands or fasteners. Any envelopes must be disposed of *before* entering the building.

- Commercial overnight mail (other than U.S. Postal Service Express Mail and Priority Mail) must be sent to 9300 East Hampton Drive, Capitol Heights, MD 20743.

- U.S. Postal Service first-class, Express, and Priority mail should be addressed to 445 12th Street, SW, Washington DC 20554.

C. Paperwork Reduction Act Analysis

99. This *Second Report and Order* contains new or modified information collection requirements subject to the Paperwork Reduction Act of 1995 (PRA), Public Law 104-13. It has been submitted to the Office of Management and Budget (OMB) for review under Section 3507(d) of the PRA. OMB, the general public, and other Federal agencies are invited to comment on the new or modified information collection requirements contained in this proceeding. In addition, we note that pursuant to the Small Business Paperwork Relief Act of 2002, Public Law 107-198, *see* 44 U.S.C. 3506(c)(4), we previously sought specific comment on how the Commission might "further reduce the information collection burden for small business concerns with fewer than 25 employees."

100. In this *Second Report and Order*, we have assessed the effects of our new restriction on the award of designated entity benefits where an applicant or licensee has agreements, which create a material relationship, with one or more other entities for the lease (under either spectrum manager or *de facto* transfer leasing arrangements) or resale (including under a wholesale arrangement) of a portion of its spectrum capacity. We find that the rule we adopt will best ensure that the Commission can continue to award designated entity benefits to entities that Congress intended. While the new rule may impose a new information collection on small businesses, including those with fewer than 25 employees, we conclude that this information collection is

necessary to ensure that the benefits of the Commission's designated entity program are reserved only for legitimate small businesses.

101. This *Second Further Notice* contains proposed new or modified information collection requirements. The Commission, as part of its continuing effort to reduce paperwork burdens, invites the general public and the Office of Management and Budget ("OMB") to comment on the information collection requirements contained in this document, as required by the Paperwork Reduction Act of 1995, Public Law 104-13. Public and agency comments are due 60 days after the date of publication in the Federal Register. Comments should address: (a) whether the proposed collection of information is necessary for the proper performance of the functions of the Commission, including whether the information shall have practical utility; (b) the accuracy of the Commission's burden estimates; (c) ways to enhance the quality, utility, and clarity of the information collected; and (d) ways to minimize the burden of the collection of information on the respondents, including the use of automated collection techniques or other forms of information technology. In addition, pursuant to the Small Business Paperwork Relief Act of 2002, Public Law 107-198, see 44 U.S.C. 3506(c)(4), we seek specific comment on how we might "further reduce the information collection burden for small business concerns with fewer than 25 employees."

D. Congressional Review Act

102. The Commission will include a copy of this *Second Report and Order* and *Second Further Notice* in a report it will send to Congress and the Government Ac-

countability Office pursuant to the Congressional Review Act, *see* 5 U.S.C. 801(a)(1)(A).

E. Ordering Clauses

103. Accordingly, IT IS ORDERED that, pursuant to sections 4(i), 303(r), and 309(j) of the Communications Act of 1934, as amended, 47 U.S.C. sections 154(i), 303(r), and 309(j), this *Second Report and Order* is hereby ADOPTED and Part 1 of the Commission's rules, 47 C.F.R. Part 1, is AMENDED as set forth below in Appendix B, effective 30 days after publication in the Federal Register, except for the grandfathering provisions which are effective upon release.

104. IT IS FURTHER ORDERED that pursuant to sections 4(i), 303(r), and 309(j) of the Communications Act of 1934, as amended, 47 U.S.C. sections 154(i), 303(r), and 309(j), this *Second Further Notice of Proposed Rule Making* is HEREBY ADOPTED.

105. IT IS FURTHER ORDERED that, pursuant to 47 U.S.C. § 155(c) and 47 C.F.R. §§ 0.131(c) and 0.331, the Chief of the Wireless Telecommunications Bureau IS GRANTED DELEGATED AUTHORITY to prescribe and set forth procedures for the implementation of the provisions adopted herein.

106. IT IS FURTHER ORDERED that the Commission's Consumer and Governmental Affairs Bureau, Reference Information Center, SHALL SEND a copy of this *Second Report and Order* and *Second Further Notice*, including the Final Regulatory Flexibility Analysis and the Initial Regulatory Flexibility Analysis, to the Chief Counsel for Advocacy of the Small Business Administration.

FEDERAL COMMUNICATIONS COMMISSION

Marlene H. Dortch
Secretary

APPENDIX A

Commenters

Comments

1. Aloha Partners, L.P. ("Aloha")
2. Antares, Inc. ("Antares")
3. Carroll Wireless, L.P. ("Carroll Wireless")
4. Centennial Communications Corp. ("Centennial")
5. Columbia Capital LLC ("Columbia Capital")
6. Communications Advisory Counsel ("CAC")
7. Comscape Telecommunications, Inc. ("Comscape")
8. Cook Inlet Region, Inc. ("Cook Inlet")
9. Council Tree Communications, Inc. ("Council Tree")
10. CTIA—The Wireless Association ("CTIA")
11. Dobson Communications Corporation ("Dobson")
12. Doyon Communications, Inc. ("Doyon")
13. Dull, Arvin D.
14. John Staurulakis, Inc.
15. Leap Wireless International, Inc. ("Leap")
16. Madison Dearborn Partners, LLC ("Madison Dearborn")
17. MetroPCS Communications, Inc. ("MetroPCS")
18. Minority Media and Telecommunications Council ("MMTC")

19. MobiPCS

20. National Association of Broadcasters ("NAB")

21. National Hispanic Media Coalition ("NHMC")

22. National Telecommunications Cooperative Association ("NTCA")

23. NTCH, Inc.

24. NTCH, Inc, dba Clear Talk ("Clear Talk")

25. Paging Systems, Inc. ("Paging Systems")

26. Patrick, Levi

27. Poplar Associates, LLC ("Poplar")

28. Rural Telecommunications Group, Inc. ("RTG")

29. STX Wireless, LLC ("STX")

30. Suncom Wireless, Inc. ("Suncom")

31. T-Mobile USA, Inc. ("T-Mobile")

32. United States Cellular Corporation ("USCC")

33. U.S. Wirefree

34. Verizon Wireless ("Verizon Wireless")

35. Wirefree Partners III, LLC ("Wirefree Partners")

36. Wireless Broadband Service Providers Association ("WBSPA")

37. Wireless Communications Association International, Inc. ("WCAI")

Reply Comments

1. Antares, Inc. ("Antares")
2. Blooston Rural De Colalition ("Blooston")
3. Cablevision Systems Corporation ("CSC")
4. Cingular Wireless, LLC ("Cingular")
5. Consumers Union
6. Cook Inlet Region, Inc. ("Cook Inlet")
7. Council Tree Communications, Inc. ("Council Tree")
8. Ericsson, Inc. ("Ericsson")
9. Leap Wireless International, Inc. ("Leap")
10. Minority Media and Telecommunications Council ("MMTC")
11. Royal Street Communications, LLC ("Royal Street")
12. Rural Carriers
13. T-Mobile USA, Inc. ("T-Mobile")
14. United States Cellular Corporation ("USCC")
15. U.S. Wirefree
16. Verizon Wireless ("Verizon Wireless")
17. Wirefree Partners III, LLC ("Wirefree Partners")
18. Wireless Broadband Service Providers Association ("WBSPA")

Notice of *Ex Parte* Presentations

1. Carroll Wireless et al ("Carroll")

2. Cook Inlet Region, Inc. ("Cook Inlet")*

3. Council Tree Communications, Inc. ("Council Tree")*

4. CTIA—The Wireless Association ("CTIA")

5. Doyon Communications, Inc. ("Doyon")

6. Madison Dearborn Partners, LLC ("Madison Dearborn")

7. Media Access Project ("MAP")*

8. MetroPCS Communications, Inc. ("MetroPCS")*

9. Minority Media and Telecommunications Council ("MMTC")

10. National Hispanic Media Coalition ("NHMC")*

11. National Telecommunications Cooperative Association ("NTCA")

12. Royal Street Communications, LLC ("Royal Street")*

13. T-Mobile USA, Inc. ("T-Mobile")*

14. Transactional Transparency and Related Outreach Subcommittee

15. U.S. Department of Justice

16. Verizon Wireless ("Verizon Wireless")*

17. Wirefree Partners III, LLC ("Wirefree Partners")

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* Indicates that more than one *ex parte* submission was filed.

APPENDIX B
Final Rules

PART 1—PRACTICE AND PROCEDURE

For the reasons discussed in the preamble, the FCC amends parts 1 of the Code of Federal Regulations to read as follows:

1. The authority citation for part 1 is revised to read as follows:

Authority: 15 U.S.C. 79 *et seq.*; 47 U.S.C. 151, 154(i), 154(j), 155, 157, 225, 303(r), and 309.

2. In § 1.913, paragraph (a) introductory text and the first sentence of paragraph (b) are revised and paragraph (a)(6) is added to read as follows:

§ 1.913 Application and notification forms; electronic and manual filing.

(a) Application and notification forms. Applicants, licensees, and spectrum lessees (see § 1.9003) shall use the following forms and associated schedules for all applications and notifications:

* * * * *

(6) FCC Form 609, Application to Report Eligibility Event. FCC Form 609 is used by licensees to apply for Commission approval of reportable eligibility events, as defined in § 1.2114.

(b) Electronic filing. Except as specified in paragraph (d) of this section or elsewhere in this chapter, all applications and other filings using the application and notification forms listed in this section or associated sched-

ules must be filed electronically in accordance with the electronic filing instructions provided by ULS.

* * *

* * * * *

3. Revise paragraph (b) introductory text and add paragraph (b)(5) to § 1.919 to read as follows:

§ 1.919 Ownership information.

* * * * *

(b) Any applicant or licensee that is subject to the reporting requirements of §1.2112 or § 1.2114 shall file an FCC Form 602, or file an updated form if the ownership information on a previously filed FCC Form 602 is not current, at the time it submits:

* * * * *

(5) An application reporting any reportable eligibility event, as defined in § 1.2114.

* * * * *

4. Revise paragraph (a)(2)(ii)(B) of § 1.2105 to read as follows:

§ 1.2105 Bidding application and certification procedures; prohibition of collusion.

(a) * * *

(2) * * *

(ii)(B) Applicant ownership and other information, as set forth in 1.2112.

* * * * *

5. In paragraph § 1.2110, paragraphs (b)(1)(i)-(ii) and (j) are revised, paragraphs (n) and (o) are redesignated as paragraphs (o) and (p), and paragraphs (b)(3)(iv) and (n) are added to read as follows:

§ 1.2110 Designated entities.

* * * * *

(b) * * *

(1) Size attribution.

(i) The gross revenues of the applicant (or licensee), its affiliates, its controlling interests, the affiliates of its controlling interests, and the entities with which it has an attributable material relationship shall be attributed to the applicant (or licensee) and considered on a cumulative basis and aggregated for purposes of determining whether the applicant (or licensee) is eligible for status as a small business, very small business, or entrepreneur, as those terms are defined in the service-specific rules. An applicant seeking status as a small business, very small business, or entrepreneur, as those terms are defined in the service-specific rules, must disclose on its short- and long-form applications, separately and in the aggregate, the gross revenues for each of the previous three years of the applicant (or licensee), its affiliates, its controlling interests, the affiliates of its controlling interests, and the entities with which it has an attributable material relationship.

(ii) If applicable, pursuant to § 24.709, the total assets of the applicant (or licensee), its affiliates, its controlling interests, the affiliates of its controlling interests, and the entities with which it has an attributable material relationship shall be attributed to the applicant (or li-

censee) and considered on a cumulative basis and aggregated for purposes of determining whether the applicant (or licensee) is eligible for status as an entrepreneur. An applicant seeking status as an entrepreneur must disclose on its short- and long-form applications, separately and in the aggregate, the gross revenues for each of the previous two years of the applicant (or licensee), its affiliates, its controlling interests, the affiliates of its controlling interests, and the entities with which it has an attributable material relationship.

* * * * *

(3) * * *

(iv) Applicants or licensees with material relationships.

(A) Impermissible material relationships. An applicant or licensee that would otherwise be eligible for designated entity benefits under this section and applicable service-specific rules shall be ineligible for such benefits if the applicant or licensee has an impermissible material relationship. An applicant or licensee has an impermissible material relationship when it has arrangements with one or more entities for the lease or resale (including under a wholesale agreement) of, on a cumulative basis, more than 50 percent of the spectrum capacity of any one of the applicant's or licensee's licenses.

(B) Attributable material relationships. An applicant or licensee must attribute the gross revenues (and, if applicable, the total assets) of any entity, (including the controlling interests, affiliates, and affiliates of the controlling interests of that entity) with which the applicant or licensee has an attributable material relationship. An applicant or licensee has an attributable material rela-

tionship when it has one or more arrangements with any individual entity for the lease or resale (including under a wholesale agreement) of, on a cumulative basis, more than 25 percent of the spectrum capacity of any one of the applicant's or licensee's licenses.

(C) Grandfathering.

(1) Licensees. An impermissible or attributable material relationship shall not disqualify a licensee for previously awarded benefits with respect to a license awarded before April 25, 2006, based on spectrum lease or resale (including wholesale) arrangements entered into before April 25, 2006.

(2) Applicants. An impermissible or attributable material relationship shall not disqualify an applicant seeking eligibility in an application for a license, authorization, assignment, or transfer of control or for partitioning or disaggregation filed before April 25, 2006, based on spectrum lease or resale (including wholesale) arrangements entered into before April 25, 2006. Any applicant seeking eligibility in an application for a license, authorization, assignment, or transfer of control or for partitioning or disaggregation filed after April 25, 2006, or in an application to participate in an auction in which bidding begins on or after [30 days after Federal Register publication], need not attribute the material relationship(s) of those entities that are its affiliates based solely on section 1.2110(c)(5)(i)(C) if those affiliates entered into such material relationship(s) before April 25, 2006, and are subject to a contractual prohibition preventing them from contributing to the applicant's total financing.

Example to paragraph (C)(2): Newco is an applicant seeking designated entity status in an auction in which bidding begins after the effective date of the rules. Investor is a controlling interest of Newco. Investor also is a controlling interest of Existing DE. Existing DE previously was awarded designated entity benefits and has impermissible material relationships based on leasing agreements entered into before April 25, 2006, with a third party, Lessee, that were in compliance with the Commission's designated eligibility standards prior to April 25, 2006,. In this example, Newco would not be prohibited from acquiring designated entity benefits solely because of the existing impermissible material relationships of its affiliate, Existing DE. Newco, Investor, and Existing DE, however, would need to enter into a contractual prohibition that prevents Existing DE from contributing to the total financing of Newco.

* * * * *

(j) Designated entities must describe on their long-form applications how they satisfy the requirements for eligibility for designated entity status, and must list and summarize on their long-form applications all agreements that affect designated entity status such as partnership agreements, shareholder agreements, management agreements, spectrum leasing arrangements, spectrum resale (including wholesale) arrangements, and all other agreements, including oral agreements, establishing, as applicable, de facto or de jure control of the entity or the presence or absence of impermissible and attributable material relationships. Designated entities also must provide the date(s) on which they entered into each of the agreements listed. In addition, designated entities must file with their long-form applications a

copy of each such agreement. In order to enable the Commission to audit designated entity eligibility on an ongoing basis, designated entities that are awarded eligibility must, for the term of the license, maintain at their facilities or with their designated agents the lists, summaries, dates, and copies of agreements required to be identified and provided to the Commission pursuant to this paragraph and to § 1.2114.

* * * * *

(n) Annual reports. Each designated entity licensee must file with the Commission an annual report within five business days before the anniversary date of the designated entity's license grant. The annual report shall include, at a minimum, a list and summaries of all agreements and arrangements (including proposed agreements and arrangements) that relate to eligibility for designated entity benefits. In addition to a summary of each agreement or arrangement, this list must include the parties (including affiliates, controlling interests, and affiliates of controlling interests) to each agreement or arrangement, as well as the dates on which the parties entered into each agreement or arrangement. Annual reports will be filed no later than, and up to five business days before, the anniversary of the designated entity's license grant.

(o) Gross revenues. * * *

(p) Total assets. * * *

6. Revise paragraphs (a), (b) introductory text, the first sentence of paragraph (c)(2), the first sentence of paragraph (c)(3), (d)(1), and (d)(2) of § 1.2111 to read as follows:

§ 1.2111 Assignment or transfer of control: unjust enrichment.

(a) Reporting requirement. An applicant seeking approval for a transfer of control or assignment (otherwise permitted under the Commission's Rules) of a license within three years of receiving a new license through a competitive bidding procedure must, together with its application for transfer of control or assignment, file with the Commission's statement indicating that its license was obtained through competitive bidding. Such applicant must also file with the Commission the associated contracts for sale, option agreements, management agreements, or other documents disclosing the local consideration that the applicant would receive in return for the transfer or assignment of its license (see § 1.948). This information should include not only a monetary purchase price, but also any future, contingent, in-kind, or other consideration (e.g., management or consulting contracts either with or without an option to purchase; below market financing).

(b) Unjust enrichment payment: set-aside. As specified in this paragraph an applicant seeking approval for a transfer of control or assignment (otherwise permitted under the Commission's Rules) of, or for entry into a material relationship (see §§ 1.2110, 1.2114) (otherwise permitted under the Commission's rules) involving, a license acquired by the applicant pursuant to a set-aside for eligible designated entities under § 1.2110(c), or which proposes to take any other action relating to ownership or control that will result in loss of eligibility as a designated entity, must seek Commission approval and may be required to make an unjust enrichment payment (Payment) to the Commission by cashier's check or wire

transfer before consent will be granted. The Payment will be based upon a schedule that will take account of the term of the license, any applicable construction benchmarks, and the estimated value of the set-aside benefit, which will be calculated as the difference between the amount paid by the designated entity for the license and the value of comparable non-set-aside license in the free market at the time of the auction. The Commission will establish the amount of the Payment and the burden will be on the applicants to disprove this amount. No payment will be required if:

* * *

(c) * * *

(2) If a licensee that utilizes installment financing under this section seeks to make any change in ownership structure or to enter into a material relationship (see § 1.2110) that would result in the licensee losing eligibility for installment payments, the licensee shall first seek Commission approval and must make full payment of the remaining unpaid principal and any unpaid interest accrued through the date of such change as a condition of approval. * * *

(3) If a licensee seeks to make any change in ownership or to enter into a material relationship (see § 1.2110) that would result in the licensee qualifying for a less favorable installment plan under this section, the licensee shall seek Commission approval and must adjust its payment plan to reflect its new eligibility status. * * *

(d) * * *

(1) A licensee that utilizes a bidding credit, and that during the initial term seeks to assign or transfer control of a license to an entity that does not meet the eligibility criteria for a bidding credit, will be required to reimburse the U.S. Government for the amount of the bidding credit, plus interest based on the rate for ten year U.S. Treasury obligations applicable on the date the license was granted, as a condition of Commission approval of the assignment or transfer. If, within the initial term of the license, a licensee that utilizes a bidding credit seeks to assign or transfer control of a license to an entity that is eligible for a lower bidding credit, the difference between the bidding credit obtained by the assigning party and the bidding credit for which the acquiring party would qualify, plus interest based on the rate for ten year U.S. treasury obligations applicable on the date the license is granted, must be paid to the U.S. Government as a condition of Commission approval of the assignment or transfer. If, within the initial term of the license, a licensee that utilizes a bidding credit seeks to make any ownership change or to enter into a material relationship (see § 1.2110) that would result in the licensee losing eligibility for a bidding credit (or qualifying for a lower bidding credit), the amount of the bidding credit (or the difference between the bidding credit originally obtained and the bidding credit for which the licensee would qualify after restructuring or entry into a material relationship), plus interest based on the rate for ten year U.S. treasury obligations applicable on the date the license is granted, must be paid to the U.S. Government as a condition of Commission approval of the assignment or transfer or of a reportable eligibility event (see § 1.2114).

(2) Payment schedule.

(i) The amount of payments made pursuant to paragraph (d)(1) of this section will be 100 percent of the value of the bidding credit prior to the filing of the notification informing the Commission that the construction requirements applicable at the end of the initial license term have been met. If the notification informing the Commission that the construction requirements applicable at the end of the initial license term have been met, the amount of the payments will be reduced over time as follows:

(A) A loss of eligibility in the first five years of the license term will result in a forfeiture of 100 percent of the value of the bidding credit (or in the case of eligibility changing to qualify for a lower bidding credit, 100 percent of the difference between the bidding credit received and the bidding credit for which it is eligible);

(B) A loss of eligibility in years 6 and 7 of the license term will result in a forfeiture of 75 percent of the value of the bidding credit (or in the case of eligibility changing to qualify for a lower bidding credit, 75 percent of the difference between the bidding credit received and the bidding credit for which it is eligible);

(C) A loss of eligibility in years 8 and 9 of the license term will result in a forfeiture of 50 percent of the value of the bidding credit (or in the case of eligibility changing to qualify for a lower bidding credit, 50 percent of the difference between the bidding credit received and the bidding credit for which it is eligible); and

(D) A loss of eligibility in year 10 of the license term will result in a forfeiture of 25 percent of the value of the

bidding credit (or in the case of eligibility changing to qualify for a lower bidding credit, 25 percent of the difference between the bidding credit received and the bidding credit for which it is eligible).

(ii) These payments will have to be paid to the United States Treasury as a condition of approval of the assignment, transfer, ownership change, or reportable eligibility event (see §1.2114).

* * * * *

7. In § 1.2112, add new paragraphs (b)(1)(iii) and (b)(2)(vii), redesignate paragraph (b)(1)(iii) as (b)(1)(iv), and revise redesignated paragraph (b)(1)(iv) and paragraphs (b)(2)(iii) and (v) of to read as follows:

§ 1.2112 Ownership disclosure requirements for applications.

* * * * *

(b) * * *

(1) * * *

(iii) List all parties with which the applicant has entered into arrangements for the spectrum lease or resale (including wholesale agreements) of any of the capacity of any of the applicant's spectrum.

(iv) List separately and in the aggregate the gross revenues, computed in accordance with § 1.2110, for each of the following: The applicant, its affiliates, its controlling interests, the affiliates of its controlling interests, and the entities with which it has an attributable material relationship; and if a consortium of small businesses, the members comprising the consortium.

* * * * *

(2) * * *

(iii) List and summarize all agreements or instruments (with appropriate references to specific provisions in the text of such agreements and instruments) that support the applicant's eligibility as a small business under the applicable designated entity provisions, including the establishment of de facto or de jure control or the presence or absence of impermissible and attributable material relationships. Such agreements and instruments include articles of incorporation and bylaws, partnership agreements, shareholder agreements, voting or other trust agreements, management agreements, franchise agreements, spectrum leasing arrangements, spectrum resale (including wholesale) arrangements, and any other relevant agreements (including letters of intent), oral or written;

(iv) * * *

(v) List separately and in the aggregate the gross revenues, computed in accordance with § 1.2110, for each of the following: the applicant, its affiliates, its controlling interests, affiliates of its controlling interests, and parties with which it has attributable material relationships; and if a consortium of small businesses, the members comprising the consortium; and

(vi) * * *

(vii) List and summarize any agreements in which the applicant has entered into arrangements for the lease or resale (including wholesale agreements) of any of the spectrum capacity of the license that is the subject of the application.

8. Add new section 1.2114 to read as follows:

§ 1.2114 Reporting of Eligibility Event.

(a) A designated entity must seek Commission approval for all reportable eligibility events. A reportable eligibility event is:

(1) Any spectrum lease (as defined in § 1.9003) or resale arrangement (including wholesale agreements) with one entity or on a cumulative basis that would cause a licensee to lose eligibility for installment payments, a set-aside license, or a bidding credit (or for a particular level of bidding credit) under § 1.2110 and applicable service-specific rules.

(2) Any other event that would lead to a change in the eligibility of a licensee for designated entity benefits.

(b) Documents listed on and filed with application. A designated entity filing an application pursuant to this section must—

(1) List and summarize on the application all agreements and arrangements (including proposed agreements and arrangements) that give rise to or otherwise relate to a reportable eligibility event. In addition to a summary of each agreement or arrangement, this list must include the parties (including each party's affiliates, its controlling interests, the affiliates of its controlling interests, its spectrum lessees, and its spectrum resellers and wholesalers) to each agreement or arrangement, as well as the dates on which the parties entered into each agreement or arrangement.

(2) File with the application a copy of each agreement and arrangement listed pursuant to this paragraph.

(3) Maintain at its facilities or with its designated agents, for the term of the license, the lists, summaries, dates, and copies of agreements and arrangements required to be provided to the Commission pursuant to this section.

(c) Application fees. The application reporting the eligibility event will be treated as a transfer of control for purposes of determining the applicable application fees as set forth in § 1.1102.

(d) Streamlined approval procedures.

(1) The eligibility event application will be placed on public notice once the application is sufficiently complete and accepted for filing (see § 1.933).

(2) Petitions to deny filed in accordance with § 309(d) of the Communications Act must comply with the provisions of § 1.939, except that such petitions must be filed no later than 14 days following the date of the Public Notice listing the application as accepted for filing.

(3) No later than 21 days following the date of the Public Notice listing an application as accepted for filing, the Wireless Telecommunications Bureau (Bureau) will grant the application, deny the application, or remove the application from streamlined processing for further review.

(4) Grant of the application will be reflected in a Public Notice (see § 1.933(a)(2)) promptly issued after the grant.

(5) If the Bureau determines to remove an application from streamlined processing, it will issue a Public Notice indicating that the application has been removed

from streamlined processing. Within 90 days of that Public Notice, the Bureau will either take action upon the application or provide public notice that an additional 90-day period for review is needed.

(e) Public notice of application. Applications under this subpart will be placed on an informational public notice on a weekly basis (see § 1.933(a)).

(f) Contents of the application. The application must contain all information requested on the applicable form, any additional information and certifications required by the rules in this chapter, and any rules pertaining to the specific service for which the application is filed.

(g) The designated entity is required to update any change in a relationship that gave rise to a reportable eligibility event.

APPENDIX C
Final Regulatory Flexibility Analysis

As required by the Regulatory Flexibility Act (RFA),[203] an Initial Regulatory Flexibility Analysis (IRFA) was incorporated into the Further Notice of Proposed Rule Making ("*Further Notice*") in WT Docket No. 05-211. The Commission sought written public comment in the Further Notice on possible changes to its competitive bidding rules, as well as on the IRFA.[204] One commenter addressed the IRFA. This Final Regulatory Flexibility Analysis conforms to the IRFA.[205]

A. Need for, and Objectives of, the Second Report and Order

This *Second Report and Order* adopts modifications to the Commission's rules for determining the eligibility of applicants for size-based benefits in the context of competitive bidding. Over the last decade, the Commission has engaged in numerous rulemakings and adjudicatory investigations to prevent companies from circumventing the objectives of the designated entity eligibility rules.[206] To that end, in determining whether to award

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[203] *See generally* 5 U.S.C. § 603. The RFA, *see* 5 U.S C. §§ 601—612, has been amended by the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA), Pub. L No 104-121, Title II, 110 Stat. 857 (1996).

[204] Implementation of the Commercial Spectrum Enhancement Act and Modernization of the Commission's Competitive Bidding Rules and Procedures, WT Docket No. 05-211, *Further Notice of Proposed Rule Making*, 21 FCC Rcd 1753 (2006), 71 FR 6992 (February 10, 2006).

[205] *See generally* 5 U.S.C. § 604.

[206] *See, e g., Competitive Bidding Second Report and Order*, 9 FCC Rcd 2348 (1994); *Part 1 Fifth Report and Order*, 15 FCC Rcd 15293

designated entity benefits, the Commission adopted a strict eligibility standard that focused on whether the applicant maintained control of the corporate entity.[207] The Commission's objective in employing such a standard was "to deter the establishment of sham companies in a manner that permits easy resolution of eligibility issues without the delay of administrative hearings."[208] The Commission intends its small business provisions to be available only to bona fide small businesses.

Consequently, the rules as modified by the *Second Report and Order* provide that certain material relationships of an applicant for designated entity benefits will be a factor in determining the applicant's eligibility. The *Second Report and Order* provides that if an applicant or licensee has agreements that together enable it to lease or resell more than 50 percent of the spectrum capacity of any individual licenses, the applicant or licensee will be ineligible for designated entity benefits. Further, the *Second Report and Order* also provides that if an applicant or licensee has agreements with any other entity, including entities or individuals attributable to that other entity that enable the applicant or licensee to lease or resell more than 25 percent of the spectrum capacity of any individual licenses, the other entity will be attributed to the applicant or licensee when determining the applicant's or licensee's eligibility for designated entity benefits. Finally, the modifications of the *Second Report and Order* strengthen the

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(2000); Application of ClearComm, L P., *Memorandum Opinion and Order*, 16 FCC Rcd 18627 (2001).

[207] *Competitive Bidding Second Report and Order*, 9 FCC Rcd at 2396, ¶ 277.

[208] *Id.* at 2397 ¶ 278.

Commission's unjust enrichment rules to better deter attempts at circumvention and to recapture designated entity benefits when there has been a change in eligibility on a license-by-license basis. Similarly, to ensure our continued ability to safeguard the award of designated entity benefits, we provide clarification regarding how the Commission will implement its rules concerning audits and we refine our rules with respect to the reporting obligations of designated entities.

These rule modifications will enhance the Commission's ability to carry out Congress's statutory plan in accordance with the intent of Congress that every recipient of designated entity benefits uses its licenses directly to provide facilities-based telecommunications services for the benefit of the public. In making these changes to the rules, the Commission takes another important step in fulfilling its statutory mandate to facilitate the participation of small businesses in the provision of spectrum based services.[209]

B. Summary of Significant Issues Raised By Public Comment in Response to the IRFA

The National Telecommunications Cooperative Association filed comments in response to the IRFA stating, among other things, that the Commission must take steps to minimize the economic impact of its proposed rules on small entities. NTCA asserts that the Commission must tailor its rules narrowly enough to target only real abuse, rather than capturing all rural telephone companies with any ties to a large in-region wireless

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[209] 47 U.S.C. §309(j)(4)(D).

provider, or it should exempt rural telephone companies from the rules' provision.[210]

C. Description and Estimate of the Number of Small Entities to Which the Proposed Rules Will Apply

The RFA directs agencies to provide a description of and, where feasible, an estimate of the number of small entities that may be affected by the proposed rules, if adopted.[211] The RFA generally defines the term "small entity" as having the same meaning as the terms "small organization," "small business," and "small governmental jurisdiction."[212] The term "small business" has the same meaning as the term "small business concern" under the Small Business Act.[213] A small business concern is one which: (1) is independently owned and operated; (2) is not dominant in its field of operation; and (3) satisfies any additional criteria established by the SBA.

A small organization is generally "any not-for-profit enterprise which is independently owned and operated and is not dominant in its field."[214] Nationwide, as of

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[210] Comments of NTCA at 9

[211] 5 U.S.C. § 603(b)(3).

[212] *Id* § 601(6).

[213] *Id.* § 601(3) (incorporating by reference the definition of "small business concern" in the Small Business Act, 15 U.S.C. § 632). Pursuant to the RFA, the statutory definition of a small business applies "unless an agency, after consultation with the Office of Advocacy of the Small Business Administration and after opportunity for public comment, establishes one or more definitions of such term which are appropriate to the activities of the agency and publishes such definition(s) in the Federal Register." *Id* § 601(3).

[214] *Id.* § 601(4).

2002, there were approximately 1.6 million small organizations.[215] The term "small governmental jurisdiction" is defined generally as "governments of cities, towns, townships, villages, school districts, or special districts, with a population of less than fifty thousand."[216] Census Bureau data for 2002 indicate that there were 87,525 local governmental jurisdictions in the United States.[217] We estimate that, of this total, 84,377 entities were "small governmental jurisdictions."[218] Thus, we estimate that most governmental jurisdictions are small. Nationwide, there are a total of approximately 22.4 million small businesses, according to SBA data.[219]

The changes and additions to the Commission's rules adopted in the *Second Report and Order* are of general applicability to all services, applying to all entities of any size that seek eligibility to participate in Commission auctions as a designated entity and/or that hold licenses won through competitive bidding that are subject to designated entity benefits. Accordingly, this FRFA provides a general analysis of the impact of the proposals on small businesses rather than a service by

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[215] Independent Sector, The New Nonprofit Almanac & Desk Reference (2002).

[216] 5 U.S.C. § 601(5).

[217] U.S. Census Bureau, Statistical Abstract of the United States 2006, Section 8, page 272, Table 415

[218] We assume that the villages, school districts, and special districts are small, and total 48,558. *See* U.S. Census Bureau, Statistical Abstract of the United States: 2006, section 8, page 273, Table 417. For 2002, Census Bureau data indicate that the total number of county, municipal, and township governments nationwide was 38,967, of which 35,819 were small. *Id.*

[219] *See* SBA, Programs and Services, SBA Pamphlet No. CO-0028, at page 40 (July 2002).

service analysis. The number of entities that may apply to participate in future Commission auctions is unknown. The number of small businesses that have participated in prior auctions has varied. In all of our auctions held to date, 1,975 out of a total of 3,545 qualified bidders either have claimed eligibility for small business bidding credits or have self-reported their status as small businesses as that term has been defined under rules adopted by the Commission for specific services.[220] In addition, we note that, as a general matter, the number of winning bidders that qualify as small businesses at the close of an auction does not necessarily represent the number of small businesses currently in service. Also, the Commission does not generally track subsequent business size unless, in the context of changes in control, changes in material relationships or assignments or transfers, unjust enrichment issues are implicated.

D. Description of Projected Reporting, Recordkeeping, and Other Compliance Requirements

The Commission will require additional information from applicants in order to ensure compliance with the policies and rules adopted by the *Second Report and Order*. For example, designated entity applicants that have filed applications to participate in an auction for which bidding will begin on or after the effective date of the rules, will be required to amend their applications on or after the effective date of the rule changes with a statement declaring, under penalty of perjury, that the applicant is qualified as a designated entity pursuant to the Commission's rules effective as of the date of the

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[220] This figure is as of March 29, 2006

statement. In addition, the Commission adopts rules to make modifications, as necessary, to FCC forms related to auction, licensing, and leasing applications. Specifically, the modifications will require that designated entities report any relevant material relationship(s), as defined in newly adopted sections of 1.2110, reached after the date the rules are published in the Federal Register, even if the material relationship between the designated entity and the other entity would not have triggered a reporting requirement under the rules prior to this *Second Report and Order*.[221]

E. Steps Taken to Minimize Significant Economic Impact on Small Entities, and Significant Alternatives Considered

The RFA requires an agency to describe any significant alternatives that it has considered in reaching its proposed approach, which may include the following four alternatives (among others): "(1) the establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (2) the clarification, consolidation, or simplification of compliance or reporting requirements under the rule for small entities; (3) the use of performance rather than design standards; and (4) an exemption from coverage of the rule or any part thereof for small entities."[222]

The *Further Notice* sought comment on several options for modifying its designated entity eligibility rules and specifically sought comment from small entities.

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[221] *See generally* 47 C.F.R §§ 1 948, 1.9020(ı), 1 9030(h), (i).

[222] *See* 5 U.S.C. § 603.

The options included various ways to consider whether the Commission should award designated entity benefits where an applicant for such benefits also had financial or operational agreements with a larger entity. In considering these options, for the purposes of determining designated entity eligibility, the Commission defined the effect of entering certain agreements. By adopting the rules in the *Second Report and Order*, the Commission will enhance its ability to carry out Congress's statutory plan that every recipient of designated entity benefits uses their licenses directly to provide facilities-based telecommunications services, for the benefit of the public.

F. Report to Congress

The Commission will send a copy of the *Second Report and Order*, including this FRFA, in a report to be sent to Congress pursuant to the SBREFA.[223] In addition, the Commission will send a copy of the *Second Report and Order*, including the FRFA, to the Chief Counsel for Advocacy of the SBA. A copy of the *Second Report and Order* and the FRFA (or summaries thereof) will also be published in the Federal Register.

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[223] *See id* § 801(a)(1)(A).

APPENDIX D
Initial Regulatory Flexibility Analysis

As required by the Regulatory Flexibility Act (RFA),[224] the Commission has prepared this Initial Regulatory Flexibility Analysis (IRFA) of the possible significant economic impact on small entities by the policies and rules proposed in the *Second Further Notice of Proposed Rule Making* ("*Second Further Notice*"). Written public comments are requested on this IRFA. Comments must be identified as responses to the IRFA and must be filed by the deadlines for comments provided in this *Second Further Notice*. The Commission will send a copy of the *Second Further Notice*, including this IRFA, to the Chief Counsel for Advocacy of the Small Business Administration (SBA).[225] In addition, the *Second Further Notice* and the IRFA (or summaries thereof) will be published in the Federal Register.[226]

A. Need for, and Objectives of, the Proposed Rules

The initial *Further Notice* in this proceeding tentatively concluded that it should restrict the award of designated entity benefits to an otherwise qualified applicant where it has a "material relationship" with a "large in-region incumbent wireless service provider." The Commission sought comment on how it should define the elements of such a restriction. Based on the Commission's experience in administering the designated entity

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[224] *See generally* 5 U.S.C. § 603. The RFA, *see* 5 U.S C. §§ 601-612, has been amended by the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA), Pub. L. No. 104-121, Title II, 110 Stat. 857 (1996).

[225] *See* 5 U S.C. § 603(a).

[226] *See id.*

program and the record developed in response to the *Further Notice*, this *Second Further Notice* seeks further comment on those issues, including comment to obtain additional economic evidence regarding how and under what circumstances an entity's size might affect its relationships and agreements with designated entity applicants and licensees. The *Second Further Notice* also seeks comment on whether the Commission should adopt additional rule changes that would restrict the award of designated entity benefits under certain circumstances and in connection with relationships with certain types of entities and individuals with high personal net worth, including whether and how in-region relationships and personal net worth should be considered in determining eligibility for designated entity benefits.

Over the last decade, the Commission has engaged in numerous rulemakings and adjudicatory investigations to prevent companies from circumventing the objectives of the designated entity eligibility rules.[227] To that end, in determining whether to award designated entity benefits, the Commission adopted a strict eligibility standard that focused on whether the applicant maintained control of the corporate entity.[228] The Commission's objective in employing such a standard was "to deter the establishment of sham companies in a manner that permits easy resolution of eligibility issues without

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[227] *See, e g , Competitive Bidding Second Report and Order*, 9 FCC Rcd 2348 (1994); *Part 1 Fifth Report and Order*, 15 FCC Rcd 15293 (2000); Application of ClearComm, L P., *Memorandum Opinion and Order*, 16 FCC Rcd 18627 (2001).

[228] *Competitive Bidding Second Report and Order*, 9 FCC Rcd at 2396 ¶ 277.

the delay of administrative hearings."[229] The Commission intends its small business provisions to be available only to bona fide small businesses.

B. Legal Basis

The proposed actions are authorized under Sections 4(i), 303(r), and 309(j) of the Communications Act of 1934, as amended, 47 U.S.C. Sections 154(i), 303(r), and 309(j).

C. Description and Estimate of the Number of Small Entities to Which the Proposed Rules Will Apply

The RFA directs agencies to provide a description of and, where feasible, an estimate of the number of small entities that may be affected by the proposed rules, if adopted.[230] The RFA generally defines the term "small entity" as having the same meaning as the terms "small organization," "small business," and "small governmental jurisdiction."[231] The term "small business" has the same meaning as the term "small business concern" under the Small Business Act.[232] A small business concern is one which: (1) is independently owned and

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[229] *Id.* at 2397 ¶ 278.

[230] 5 U.S.C. § 603(b)(3).

[231] *Id* § 601(6).

[232] *Id* § 601(3) (incorporating by reference the definition of "small business concern" in the Small Business Act, 15 U.S.C. § 632). Pursuant to the RFA, the statutory definition of a small business applies "unless an agency, after consultation with the Office of Advocacy of the Small Business Administration and after opportunity for public comment, establishes one or more definitions of such term which are appropriate to the activities of the agency and publishes such definition(s) in the Federal Register." *Id* § 601(3).

operated; (2) is not dominant in its field of operation; and (3) satisfies any additional criteria established by the SBA.

A small organization is generally "any not-for-profit enterprise which is independently owned and operated and is not dominant in its field."[233] Nationwide, as of 2002, there were approximately 1.6 million small organizations.[234] The term "small governmental jurisdiction" is defined as "governments of cities, towns, townships, villages, school districts, or special districts, with a population of less than fifty thousand."[235] Census Bureau data for 2002 indicate that there were 87,525 local governmental jurisdictions in the United States.[236] We estimate that, of this total, 84,377 entities were "small governmental jurisdictions."[237] Thus, we estimate that most governmental jurisdictions are small. Nationwide, there are a total of approximately 22.4 million small businesses, according to SBA data.[238]

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[233] *Id.* § 601(4).

[234] Independent Sector, The New Nonprofit Almanac & Desk Reference (2002).

[235] 5 U.S.C. § 601(5).

[236] U.S. Census Bureau, Statistical Abstract of the United States: 2006, Section 8, page 272, Table 415.

[237] We assume that the villages, school districts, and special districts are small, and total 48,558. *See* U.S. Census Bureau, Statistical Abstract of the United States: 2006, section 8, page 273, Table 417. For 2002, Census Bureau data indicate that the total number of county, municipal, and township governments nationwide was 38,967, of which 35,819 were small. *Id.*

[238] *See* SBA, Programs and Services, SBA Pamphlet No. CO-0028, at 40 (July 2002).

Any proposed changes or additions to the Commission's Part 1 rules that may be made as a result of the *Second Further Notice* would be of general applicability to all services, applying to all entities of any size that apply to participate in Commission auctions. Accordingly, this IRFA provides a general analysis of the impact of the proposals on small businesses rather than a service by service analysis. The number of entities that may apply to participate in future Commission auctions is unknown. The number of small businesses that have participated in prior auctions has varied. In all of our auctions held to date, 1,975 out of a total of 3,545 qualified bidders either have claimed eligibility for small business bidding credits or have self-reported their status as small businesses as that term has been defined under rules adopted by the Commission for specific services.[239] In addition, we note that, as a general matter, the number of winning bidders that qualify as small businesses at the close of an auction does not necessarily represent the number of small businesses currently in service. Also, the Commission does not generally track subsequent business size unless, in the context of assignments or transfers, unjust enrichment issues are implicated.

D. Description of Projected Reporting, Recordkeeping, and Other Compliance Requirements

The Commission will not require additional reporting, recordkeeping or other compliance requirements pursuant to this *Second Further Notice*.

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[239] This figure is as of March 29, 2006

E. Steps Taken to Minimize Significant Economic Impact on Small Entities, and Significant Alternatives Considered

The RFA requires an agency to describe any significant alternatives that it has considered in reaching its proposed approach, which may include the following four alternatives (among others): (1) the establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (2) the clarification, consolidation, or simplification of compliance or reporting requirements under the rule for small entities; (3) the use of performance, rather than design, standards; and (4) an exemption from coverage of the rule or any part thereof for small entities.[240]

The initial *Further Notice* in this proceeding tentatively concluded that it should restrict the award of designated entity benefits to an otherwise qualified applicant where it has a "material relationship" with a "large in-region incumbent wireless service provider." The Commission sought comment on how it should define the elements of such a restriction. Based on the Commission's experience in administering the designated entity program and the record developed in response to the *Further Notice*, this *Second Further Notice* seeks further comment on those issues, including comment to obtain additional economic evidence regarding how and under what circumstances an entity's size might affect its relationships and agreements with designated entity applicants and licensees. The *Second Further Notice* also seeks comment on whether the Commission should

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[240] *See* 5 U.S.C. § 603

adopt additional rule changes that would restrict the award of designated entity benefits under certain circumstances and in connection with relationships with certain types of entities and individuals with high personal net worth, including whether and how in-region relationships and personal net worth should be considered in determining eligibility for designated entity benefits. The *Second Further Notice* seeks guidance from the industry on how it should define the elements of any restrictions it might adopt regarding the award of designated entity benefits. Small entity comments are specifically requested.

F. Federal Rules that May Duplicate, Overlap, or Conflict with the Proposed Rule

None.

STATEMENT OF CHAIRMAN KEVIN J. MARTIN

Re: Implementation of the Commercial Spectrum Enhancement Act and Modernization of the Commission's Competitive Bidding Rules and Procedures, WT Docket No. 05-211, Second Report and Order and Second Further Notice of Proposed Rule Making.

We initiated this proceeding to examine our rules governing designated entities to better achieve the purpose of ensuring that small businesses have an opportunity to participate in the provision of spectrum-based services. Today's order adopts several measures to help accomplish that goal. Specifically, we strengthen our unjust enrichment and spectrum leasing rules for designated entities in order to provide additional incentives for small businesses receiving bidding credits to offer facilities-based service. We also further the integrity of the designated entity program by implementing random audits, additional document and transaction reviews, and periodic reporting. Together, these measures significantly strengthen the designated entity program.

In the further notice portion of this item, we ask whether additional safeguards are necessary to reduce the opportunity for manipulation of our rules governing the provision of bidding credits to small businesses. I look forward to working with my colleagues as we continue to develop the record in this proceeding.

STATEMENT OF COMMISSIONER MICHAEL J. COPPS

Re: Implementation of the Commercial Spectrum Enhancement Act and Modernization of the Commission's Competitive Bidding Rules and Procedures, WT Docket No. 05-211, Second Report and Order and Second Further Notice of Proposed Rule Making.

In this age when telecommunications companies seem only to grow larger and larger, it is important to have programs that encourage competition from smaller entrepreneurs. This is exactly what the Designated Entity (DE) program is all about and it is why we must do everything we can to make this program perform as intended. Small companies must have a fighting chance to compete with industry giants to obtain valuable spectrum. In an era of consolidation, the program is especially important to rural areas that might otherwise remain underserved. Quite frankly, rural America seems too often to have been pushed off the big companies' radar scopes. This is a central reason why I remain strongly committed to small carriers' participation in spectrum auctions. It is good policy; it also happens to be the law.

But let's be candid. Whenever government attempts to provide incentive programs for small business, there are those who try to twist the rules in order to gain unwarranted entry into these programs. We have seen this in many business sectors and we have unfortunately experienced such chicanery and cheating in telecom too. We must not allow the bad apple to spoil the bushel, however. Instead we need good rules to curb the chicanery. Recent experience teaches us that we must move quickly to curb abuses of the DE program. News reports

indicate that, in prior auctions, entities with deep pockets helped themselves to discounts they were never meant to enjoy. This unacceptable behavior threatens the integrity of our auctions and, worse, it cheats consumers. It costs taxpayers millions of dollars in foregone revenue. It also means that spectrum goes to those most willing and able to manipulate the rules of the game, rather than to the entities Congress actually intended to benefit. And it denies consumers the benefits of new and all-too-rare competition. So, our job is to deny wealthy companies or individuals any opportunity to misuse the DE discount to outbid small carriers—the very carriers the DE program is meant to protect.

Today we take meaningful steps in the right direction. We do so in time to apply new rules to the large and important Advanced Wireless Services (AWS) auction scheduled for this summer. I am grateful to the Chairman for his role in moving this item along in time to have these rules apply to the AWS auction. And I am grateful to him and to my other colleagues for their support of strong measures to prevent fraud and unjust enrichment by those who would seek to abuse this valuable program. In particular, I am pleased that by strengthening our unjust enrichment rules we take away the incentive for speculators to try to masquerade as legitimate DEs. Under our new rules, bidders who benefit from the 25 percent discount must forfeit that discount if they then turn around and sell some or all of their license rights to someone else. By eliminating the payoff for this "flipping" of licenses, we discourage sham buyers from participating in the first place. And most importantly, we reserve the DE program for companies that actually intend to use their spectrum to serve customers.

I am also pleased that we commit to thoroughly review the application and all relevant documents for each and every winning bidder claiming DE status. Additionally, we pledge to audit every DE at least once during the initial license term. These are two important safeguards against sham bidders, and I am glad the Commission agreed to implement them as well.

There is more to do to ensure the ongoing integrity and credibility of the DE program. For instance, I have real questions about whether a company should be able to qualify for the DE discount if it is owned in large part by a multi-billion-dollar wireless company—or any multi-billion-dollar communications company, for that matter. I believe the unjust enrichment reforms we announce today will go a long way towards eliminating the worst abuses of this kind. But we still need to consider whether additional partnership restrictions are warranted.

At the same time, we must also be cautious about overshooting the mark and harming the very small carriers and entrepreneurs that Congress meant to protect. Legitimate DEs must have access to capital to compete meaningfully against the large carriers. I would not support any measures that improperly compromised their ability to do so.

The limited time available to us for consideration of this item did not allow us to resolve these questions. I would have preferred launching this proceeding last summer so as to facilitate a more thorough review in time for comprehensive action today. But given the importance of both the upcoming AWS auction and the DE program, I think that the item we announce today is the most prudent course to protect the core values of the

DE program. Certainly, we must be careful not to rush into further changes without full consideration of all their consequences, unintended as well as intended. I hope we will keep working on this program because another huge auction in the 700 MHz spectrum is not far off and we should have the program working as flawlessly as possible by then. In the meantime, I applaud the changes we make today to curb fraud and unjust enrichment and I thank my colleagues for their cooperative work to achieve these results.

STATEMENT OF COMMISSIONER JONATHAN S. ADELSTEIN APPROVING IN PART, DISSENTING IN PART

Re: Implementation of the Commercial Spectrum Enhancement Act and Modernization of the Commission's Competitive Bidding Rules and Procedures, WT Docket No. 05-211, Second Report and Order and Second Further Notice of Proposed Rule Making.

I must dissent from a large portion of this decision because it fails to accomplish the very specific goals the Commission outlined in the Further Notice and Proposed Rule Making (FNPRM) in this proceeding. While I endorse the narrow adjustments to the Designated Entity (DE) program that we adopt today, the majority falls far short of making the meaningful modifications to the DE program that were almost universally supported by commenters in this proceeding. I am disappointed that we were unable to follow through on our tentative conclusion from earlier this year, and believe that the Second FNPRM we adopt today is unnecessarily broad and complicated, and significantly ignores the full and complete record before us.

On January 27, 2006, my colleagues and I adopted an FNPRM in which we tentatively concluded that we should modify our Part 1 rules to restrict the award of designated entity benefits to an otherwise qualified designated entity where it has a "material relationship" with a "large in-region incumbent wireless service provider." This position was supported by a large and di-

verse group of commenters ranging from DEs[241] to Tier II carriers,[242] the minority community[243] to rural tele-

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[241] "It is extremely positive and encouraging that the Commission has decided to take this opportunity to change its Designated Entity program rules so as to make available more fair and reasonable opportunities for bona fide designated entities to secure the critical spectrum necessary to compete in the face of ever-increasing industry consolidation dominated by large incumbent wireless service providers." Comments of STX Wireless, LLC.

[242] "It is not unreasonable or unfair for the Commission to update its designated entity program to take into account the greatly increased concentration of spectrum resources in the hands of the national wireless carriers By limiting access of the national carriers to bid credit benefits, the Commission can effectively refocus its designated entity policies to expand opportunities for successful small business participation in the wireless industry." Reply Comments of United States Cellular Corporation at 2-3.

[243] "As carriers whose collective share of the wireless market is 89-90 percent, the five largest incumbents have the most to lose from the entry of facilities-based competitors into the wireless market, and therefore have the strongest incentives to manipulate the DE program in a manner that forestalls the competition that the DE program was meant to engender." Reply Comments of the Minority Media and Telecommunications Council (MMTC) at 3.

phone companies,[244] and even members of Congress[245] and the Department of Justice.[246]

Yet, in a troubling and curious reversal, less than three months later, I stand alone in dissenting from our decision today to not to close this obvious loophole. It is stunning that we have failed to take any meaningful action to specifically address the single biggest issue facing the DE program given the overwhelming support in the record to do so. We missed a real opportunity to shut down what almost everyone recognizes has the potential for the largest abuse of our DE program: giant wireless companies using false fronts to get spectrum on the cheap.

During the past month, there has been considerable discussion about an alternative proposal to our original

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[244] "The Commission's tentative conclusion that it should modify its Part 1 rules to restrict the award of DE benefits such as bidding credits to an otherwise qualified DE where it has a 'material relationship' with a large, in-region incumbent wireless service provider is consistent with Section 309(j) of the Communications Act of 1934, as amended." Comments of The Rural Telecommunications Group, Inc and The Organization for the Promotion and Advancement of Small Telecommunications Companies.

[245] "It is important that DEs have sources of capital and industry experience on which to rely, but allowing national wireless carriers to perform these functions is no longer good policy in light of their overwhelming dominance in the industry." Letter from 10 Members of the Congressional Black Caucus to Chairman Kevin Martin (March 3, 2006).

[246] "The Department supports the Federal Communications Commission's proposal to deny designated entity benefits to entities that have a material relationship with a large in-region incumbent wireless service provider or a large entity that has a significant interest in communications services." *Ex Parte* Letter of the Department of Justice (March 17, 2006).

tentative conclusion—a limitation on investment in DEs by all providers of communications services over a given revenue threshold. While we do not vote on that proposal here, many commenters argued that this approach would not have tightened the DE program, but rather that the approach would have killed it. I certainly had concerns that the proposal, as structured, would have cast a wide net over the DE program—limiting funding to the DE community from almost all FCC-regulated companies, manufacturers, and service providers, whether circuit or IP-based. Not surprisingly, the proposal to adopt a low revenue threshold was loudly opposed by a number of significant voices including members of Congress,[247] two subcommittees of the FCC's own Advisory Committee on Diversity for Communications in the

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[247] "It would be wholly inconsistent with the promotion of these objectives for the Commission to limit the sources of capital and expertise available to new entrants in the complex wireless industry beyond the largest national carriers identified in the rulemaking who dominate the industry." Letter from Congressman Edolphus Towns and Congresswoman Diane Watson to Commissioners Michael Copps and Jonathan Adelstein (April 7, 2006)

Digital Age,[248] current and former DEs,[249] and a quintet of Native Alaskan Corporation CEOs.[250] Some argue that so-called DE reform was really a disguise to eliminate an avenue of competition to incumbent wireless companies.[251]

Notwithstanding the flaws in this proposal, I have been willing to consider a variety of alternatives to our tentative conclusion that would have responded to com-

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[248] "The [Subcommittees] believe the Commission should receive the input of the full Committee before taking steps in response to the FNPRM released February 3, 2006 in WT Docket No. 05-211, recent reports regarding which suggest that the Commission may substantially undermine opportunities for diversity of ownership and other goals mandated by Section 309(j) of the Communications Act. Accordingly, the Subcommittee asks the Commission to convene the full Committee as soon as possible with respect to this matter." Statement of The Transactional Transparency and Related Outreach Subcommittee and the Career Advancement Subcommittee of the Advisory Committee on Diversity for Communications in the Digital Age (April 6, 2006)

[249] "Imposing severe new limitations on DEs sourcing investments from a broad category of companies defined as having revenues of $125 million or more will have the effect of killing the DE program." Ex Parte of Carroll Wireless, LP, CSM Wireless, LLC, Leap Wireless Int'l, Inc. United States Cellular Corp., TA Associates, 3G PCS, LLC, Royal Street Comme'ns, LLC, MetroPCS Comme'ns, Inc., Catalyst Investors and Council Tree Comme'ns, Inc. (April 5, 2006) ("Carroll Wireless et al").

[250] "Such ruling would effectively dismantle the DE Program as mandated by Congress. We urge the Commission to maintain the most important diversity tool at its disposal, stay with the clear record in this case and proceed with finalizing its Tentative Conclusion in this proceeding." Ex Parte of Doyon, Ltd., Koniag Development Corp., St. George Tanaq Corp Chugach Alaska Corp , and Bethel Native Corp. (April 7, 2006).

[251] Ex Parte of Carroll Wireless et al.

plaints by large wireless carriers that they were being unfairly singled out or that we were ignoring our precedent of conducting market by market analyses in looking at spectrum issues. Moreover, if the wireless loophole was adequately addressed in a final decision, I was willing to consider a revenue-based restriction that affected all FCC regulatees provided that a revenue threshold was based on the record, not one that could indiscriminately shut down the DE program. But inexplicably, no deal could be struck. Ultimately, it was easier for the majority to make a few minor changes to the DE program than close the loophole that is recognized by almost everyone but this Commission.

Of course, I support the changes made in this item as DE reform has been an important issue to me for some period of time. In my separate statement to the FNPRM, I talked about a tighter review of DE applications involving large wireless carriers and am pleased that we have extended a thorough Wireless Telecommunications Bureau review to all DE applications. And I applaud the efforts of MMTC in highlighting the need for a more rigorous audit program and advancing proposals that form the basis for those we adopt today. MMTC, like many others in this proceeding, provided thoughtful comments and discussion on the DE program, and has helped create the record that allows us to make at least some changes to the DE program prior to the upcoming AWS auction.

Finally, I must add that I am troubled by the tone and approach of the Second FNPRM. I believe it disproportionally relies on the perceived status of the communications marketplace in assessing changes to the DE program. While I recognize the dual statutory goals

highlighted in the item of ensuring opportunities for DEs and preventing unjust enrichment, we also have an obligation to promote competition and innovation in the wireless industry pursuant to Section 309(j)(3)(B), and the DE program is an appropriate vehicle to further that objective. I worry that the Second FNPRM, instead of suggesting proposals that could promote the effectiveness and integrity of DEs, could ultimately lead to determinations that do more harm to potential competition in the communications marketplace than truly protect the program. The item seems to ignore the well-developed record in proposing an unnecessarily complicated and expansive review of perceived problems of the DE program when the solutions already are right in front of us.

APPENDIX B

FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

WT Docket No. 05-211

IN THE MATTER OF IMPLEMENTATION OF THE COMMERCIAL SPECTRUM ENHANCEMENT ACT AND MODERNIZATION OF THE COMMISSION'S COMPETITIVE BIDDING RULES AND PROCEDURES

Adopted: June 1, 2006
Released: June 2, 2006

ORDER ON RECONSIDERATION OF THE SECOND REPORT AND ORDER

I. INTRODUCTION

1. In this Order on Reconsideration, on our own motion, we clarify certain aspects of the *Second Report and Order* in this proceeding ("*Designated Entity Second Report and Order*").[1] We also address certain procedural issues raised in filings submitted in response to

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[1] Implementation of the Commercial Spectrum Enhancement Act and Modernization of the Commission's Competitive Bidding Rules and Procedures, *Second Report and Order and Second Further Notice of Proposed Rule Making*, 21 FCC Rcd 4753 (2006) ("*Designated Entity Second Report and Order*" and "*Second Further Notice of Proposed Rule Making*")

the *Designated Entity Second Report and Order*.[2] As the record on reconsideration has not yet closed, however, we may deal with additional issues raised by interested parties at a later date.

II. BACKGROUND

2. In the *Further Notice of Proposed Rule Making* in this docket,[3] we sought comment on a proposal by Council Tree that we restrict the award of designated entity benefits to designated entities that have what Council Tree only generally referred to as "material relationships" with large in-region incumbent wireless service providers.[4] We asked for comment on each of

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[2] *See, e g* , Petition for Expedited Reconsideration dated May 5, 2006 ("Petition for Expedited Reconsideration") filed jointly by Council Tree Communications, Inc. ("Council Tree"), the Minority Media and Telecommunications Council ("MMTC"), and Bethel Native ("Bethel Native"); Motion for Expedited Stay Pending Reconsideration or Judicial Review dated May 5, 2006 filed jointly by Council Tree ("Motion for Expedited Stay"), MMTC and Bethel Native; CTIA—The Wireless Association Opposition to Motion for Expedited Stay Pending Reconsideration or Judicial Review dated May 11, 2006; T-Mobile USA, Inc. Opposition to Stay dated May 12, 2006; Supplement to Motion for Expedited Stay Pending Reconsideration or Judicial Review and Petition for Expedited Reconsideration dated May 17, 2006, filed jointly by Council Tree, MMTC, and Bethel Native ("Supplement"); Further Supplement to Motion for Expedited Stay dated May 25, 2006, filed jointly by Council Tree, MMTC, and Bethel Native ("Further Supplement").

[3] Implementation of the Commercial Spectrum Enhancement Act and Modernization of the Commission's Competitive Bidding Rules and Procedures, WT Docket No. 05-211, *Further Notice of Proposed Rule Making*, 21 FCC Rcd 1753 (2006) ("*Further Notice*").

[4] *See* Letter from Messrs Steve C Hillard and George T. Laub, Council Tree Communications, Inc. to Marlene H. Dortch, Secretary, Federal Communications Commission, WT Docket Nos. 02-353, 04-356, RM-10956 (June 13, 2005) (Council Tree *ex parte*).

the elements of this proposal, including what types of "material relationships" should trigger a restriction on the availability of designated entity benefits and what types of entities other than large in-region incumbent wireless service providers should be covered.[5]

3. In the *Designated Entity Second Report and Order*, after reviewing the diverse comments filed in the record and taking into consideration what we have learned in administering the designated entity benefits program,[6] we revised our rules ("Part 1" rules)[7] to in

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[5] *Further Notice*, 21 FCC Rcd at 1760 ¶ 13.

[6] *See id.* § 1.2110. The Commission establishes small business size standards on a service-specific basis, taking into consideration the characteristics and capital requirements of the particular service. 47 C.F.R. § 1.2110(c)(1). In the *Part 1 Fifth Report and Order*, the Commission, in light of the *Adarand* decision, declined to adopt special provisions for minority- and women-owned businesses but noted that minority- and women-owned businesses that qualify as small businesses may take advantage of the provisions the Commission has adopted for small businesses Amendment of Part 1 of the Commission's Rules—Competitive Bidding Procedures, WT Docket No 97-82, *Order on Reconsideration of the Third Report and Order, Fifth Report and Order, and Fourth Further Notice of Proposed Rule Making*, 15 FCC Rcd 15293, 15319 ¶ 48 (2000) ("*Part 1 Fifth Report and Order*") (citing *Adarand Constructors, Inc v. Pena*, 515 U.S. 200, 227 (1995)). On several occasions, the Commission has declined to adopt bidding credits for large telephone companies that serve rural areas. *See, e g.*, Implementation of Section 309(j) of the Communications Act—Competitive Bidding, PP Docket No. 93-253, *Fifth Memorandum Opinion and Order*, 10 FCC Rcd 403, 457-58, 462-63 ¶¶ 100, 111 (1994) ("*Competitive Bidding Fifth MO&O*"); Amendment of Part 1 of the Commission's Rules—Competitive Bidding Procedures, *Order on Reconsideration of the Third Report and Order, Fifth Report and Order, and Fourth Notice of Proposed Rule Making*, 15 FCC Rcd 15293, 15320-21 ¶¶ 51-52 (2000); Reallocation and Service Rules for the 698-746 MHz Spectrum Band (Television Channels 52-59), GN Docket No 01-74, *Report and Order*, 17 FCC Rcd

clude certain "material relationships" as factors in determining designated entity eligibility. Specifically, we adopted rules to limit the award of designated entity benefits to any applicant or licensee that has "impermissible material relationships" or an "attributable material relationship" created by certain agreements with one or more other entities for the lease or resale (including under a wholesale arrangement) of its spectrum capacity. We found that these additional eligibility restrictions were necessary to meet our statutory obligations and to ensure that, in accordance with the intent of Congress, every recipient of the Commission's designated entity benefits is an entity that uses its licenses to directly provide facilities-based telecommunications services for the benefit of the public.[8] In particular, we deter

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1022, 1090-91 ¶ 176 (2002). The Commission determines eligibility for its small business provisions based on an entity's size determined pursuant to attribution rules. 47 C.F.R. § 1.2110(b)(1)-(3). *But see* Amendment of Part 1 of the Commission's Rules—Competitive Bidding Procedures, *Second Order on Reconsideration of the Third Report and Order and Order on Reconsideration of the Fifth Report and Order*, 18 FCC Rcd 10180, 10191-94 ¶¶ 16-18 (2003) (establishing exemption for rural telephone cooperatives from the requirement that gross revenues of entities controlled by an applicant's officers and directors be attributed to the applicant), *modified on reconsideration, Second Order on Reconsideration of the Fifth Report and Order*, 20 FCC Rcd 1942 (2005); 47 C.F.R. § 1.2110(b)(3)(iii) (exempting rural telephone cooperatives from attributing the gross revenues of its officers and directors).

[7] *See* 47 C.F.R. § 1 2101 *et seq.*

[8] Section 309(j)(4)(D) directs the Commission to issue regulations to "ensure" that designated entities "are given the opportunity to participate in the provision of spectrum-based services." 47 U.S.C. § 309(j)(4)(D). We believe that the word "participate" in this directive contemplates significant involvement in the provision of services to the public, not merely passive ownership of a license to spectrum used by others to provide service. This view is supported by the legislative his-

mined that the relationships underpinning such leasing and resale agreements underscored the need for stricter regulatory parameters to ensure that benefits were reserved to provide opportunities for designated entities to become robust independent facilities-based service providers with the ability to provide new and innovative services to the public, and to prevent the unjust enrichment of unintended beneficiaries.[9]

4. In the *Further Notice*, we also sought comment on whether, if we adopted a new restriction on the award of bidding credits to designated entities, we should adopt revisions to our unjust enrichment rules. We asked over what portion of the license term the unjust enrichment provisions should apply if we decided to require reimbursement by licensees that, either through a change of "material relationships" or assignment or transfer of control of the license, lose their eligibility for a bidding credit pursuant to any eligibility restriction that we might adopt. In the *Designated Entity Second Report and Order*, after reviewing the filings in the record and taking into account our experience with spectrum auctions and licensing, we adopted rule modifications to strengthen our unjust enrichment rules in order to better deter entities from attempting to circumvent our designated entity eligibility requirements and to recapture designated entity benefits when ineligible enti-

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tory of Section 309(j), in which Congress explains that the reason for imposing anti-trafficking restrictions and unjust enrichment payment obligations on entities that receive small business benefits is to deter "participation in the licensing process by those who have no intention of offering service to the public." H R. REP. NO. 103-111, at 257-58 (1993) (Conference Agreement adopted House provisions, in relevant part, with amendments. H.R. CONF. REP. NO. 103-213, at 483 (1993)).

[9] *Designated Entity Second Report and Order*, FCC 06-52, at ¶ 21

ties control licenses held by designated entities or exert impermissible influence over a designated entity.[10] Specifically, as discussed fully below, we adopted a ten-year unjust enrichment schedule for licenses acquired with bidding credits.

5. Finally, in the *Designated Entity Second Report and Order*, in order to ensure our continued ability to safeguard the award of designated entity benefits, we explained how we will implement our rules concerning audits, particularly with respect to designated entities that win licenses in the upcoming AWS auction, and refined our rules with respect to the reporting obligations of designated entities. In the reconsideration order we adopt today, we provide guidance on these implementation rules as well as on the substantive rules mentioned above.

6. Since Federal Register publication of the *Designated Entity Second Report and Order*, several parties have submitted filings in this docket addressing various aspects of the order. As mentioned, we take note of several of these herein, including a series of filings submitted jointly by the Minority Media and Telecommunications Council ("MMTC), Council Tree Communications, Inc. ("Council Tree"), and Bethel Native Corporation ("Bethel Native") (together, "Joint Petitioners"), among which are a petition for expedited reconsideration and two supplements, a motion for expedited stay pending reconsideration or judicial review, and several lengthy *ex parte* notices. Other parties, including T-Mobile USA, Inc. ("T-Mobile") and CTIA have filed pleadings in opposition to those of Joint Petitioners.

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[10] See 47 C.F.R. § 1.2111.

III. DISCUSSION

7. On our own motion, we address arguments that it would violate section 309(j)(3)(E)(ii) of the Communications Act to apply the new designated entity rules adopted in the *Designated Entity Second Report and Order* to the licenses offered in Auction No. 66. We also address arguments that the Commission did not provide sufficient notice under the Administrative Procedure Act and Regulatory Flexibility Act before adopting its material relationship rules and new unjust enrichment rules. With respect to our material relationship rules, we clarify how we will evaluate impermissible and attributable material relationships, including those that are grandfathered, for the purpose of determining eligibility for designated entity benefits and the imposition of unjust enrichment. We also respond to arguments that our expansion of the unjust enrichment payment schedule to ten years, and requirement of reimbursement of the entire bidding credit amount by designated entities that lose their eligibility for a bidding credit prior to filing the applicable construction notification were arbitrary and capricious. In addition, we clarify that the ten-year schedule applies only to licenses granted after release of the *Designated Entity Second Report and Order*. Finally, we clarify that our new rule relating to reportable eligibility events includes events that might affect a designated entity's eligibility under either our new material relationship or existing controlling interest standards.

A. Section 309(j)(3)(E)(ii)

8. In this section, we address the claim by the Joint Petitioners that adoption of our new rules contravened

section 309(j)(3)(E)(ii) of the Communications Act.[11] Joint Petitioners specifically assert that our application of the new designated entity rules to the licenses offered in Auction No. 66 violates the section 309(j)(3)(E)(ii) directive that the Commission ensure that, after it issues bidding rules, "interested parties have sufficient time to develop business plans, assess market conditions, and evaluate the availability of equipment for the relevant services."[12] We disagree.

9. As an initial matter, we reject Joint Petitioners' basic assumption that the new designated entity rules implicate section 309(j)(3)(E)(ii) at all. While that provision instructs the Commission to promote the objective of ensuring that interested parties "after the issuance of bidding rules" have "a sufficient time to develop business plans, assess market conditions, and evaluate the availability of Federal Communications Commission equipment for the relevant services," the new designated entity rules do not constitute "bidding rules" for purposes of section 309(j)(3)(E)(ii). As the Commission has explained, this provision does not require the Commission "to postpone an auction until every external factor that might influence a bidder's business plan is resolved with absolute certainty."[13] Rather, we have indicated that the provision applies to "auction-specific information" and "specific mechanisms relating to day-to-day auction conduct including, for example, the structure of bidding rounds and stages, establishment of min-

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[11] Petition for Expedited Reconsideration at 22-23.

[12] *See* 47 U.S.C. § 309(j)(3)(E)(ii).

[13] Auction of Automated Maritime Telecommunications System Licenses Scheduled for August 21, 2005, *Public Notice*, 20 FCC Rcd 7811 (2005).

imum opening bids or reserve prices, minimum acceptable bids, initial maximum eligibility for each bidder, activity requirements for each stage of the auction, activity rule waivers, criteria for determining reductions in eligibility, information regarding bid withdrawal and bid removal, stopping rules, and information relating to auction delay, suspension, or cancellation."[14] In this case, the new designated entity rules included neither auction-specific information nor specific mechanisms relating to day-to-day auction conduct. Therefore, we do not believe that they fall under the rubric of section 309(j)(3)(E)(ii).

10. Even if, however, we were to agree with the Joint Petitioners that the new designated entity rules somehow implicate section 309(j)(3)(E)(ii), we would still reject their contention that the Commission's action here runs afoul of the statutory provision. We note that parties were on notice for many months of the Commission's intent to apply the changes to the designated entity rules adopted in this proceeding to licenses issued in Auction No. 66.[15] They thus had ample warning that a change in the designated entity rules was coming and should have been prepared to react as soon as the new rules were announced. Additionally, while the Joint Petitioners complain that the then-existing short-form filing deadline for Auction No. 66 was two weeks after the release of the new designated entity rules, auction appli-

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[14] Amendment of Part 1 of the Commission's Rules—Competitive Bidding Procedures, Third Report and Order and Second Further Notice of Proposed Rulemaking, 13 FCC Rcd 374, 448 (1997). At the same time, we retained the flexibility to announce minor changes and clarifications to such mechanisms at any time before the auction. *Id.* at 448-49.

[15] *See Further Notice* at ¶ 21.

cants are permitted, even after the short-form filing deadline, to take a variety of steps "to develop business plans, assess market conditions, and evaluate the availability of equipment for the relevant services," including adding non-controlling investors at any time before or during the auction.[16]

11. In any event, the Commission has rescheduled the deadline for filing short-form applications to participate in Auction No. 66, and interested parties now have until June 19, 2006, or 54 days after the release of the *Designated Entity Second Report and Order* to file their applications.[17] The auction itself now is scheduled to take place on August 9, 2006, or more than three months after the Commission announced its new designated entity rules. In our expert judgment, even assuming that section 309(j)(3)(E)(ii) applies to these rules, this schedule provides applicants with more than sufficient time to adjust business plans and reevaluate market conditions

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[16] *See* 47 C.F.R. § 1.2105(c). As applicants are well aware, filing a short-form application does not commit an applicant to actually participate in the auction or to make any kind of payments to the Commission. *See, e.g.*, Time Warner Cable May Bid in Wireless Auction, MarketWatch.com, May 10, 2006 (www.marketwatch.com, visited May 22, 2006) ("The company added that filing the application 'does not obligate Time Warner Cable or other companies to bid in the auction, but it provides us the flexibility to take part should we decide it makes business sense to do so.'"). And while filing an application to participate in the auction does subject applicants to certain regulatory restrictions, in practice, these restrictions do not bar a wide array of potential changes parties might wish to make to their business plans.

[17] *See* Auction of Advanced Wireless Services Licenses Rescheduled for August 9, 2006, Revised Schedule, Filing Requirements and Supplemental Procedures for Auction No. 66, *Public Notice*, FCC 06-71 (rel. May 19, 2006).

in light of the new designated entity rules.[18] Along these lines, we note that Joint Petitioners nowhere provide any estimate of what would be a sufficient period of time for designated entities to adjust to the new rules.[19] Rather, they appear to argue that so long as the new

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[18] The third element covered by Section 309(j)(3)(E)(ii)—evaluation of equipment availability—is not relevant under the circumstances here; neither the change in the designated entity rules nor the delay in the Auction No. 66 schedule would have had any conceivable effect on a potential bidder's evaluation of equipment availability.

[19] We note that in its *Further Supplement to Motion for Expedited Stay* ("*Further Supplement*"), Joint Petitioners assert that "the Commission has established a standard practice that significant changes to the core bidding rules contained in Subpart Q will only become effective *sixty* days following publication in the *Federal Register*." *Further Supplement* at 2, n 2 (emphasis in original) Contrary to Joint Petitioners' assertion, the Commission always has evaluated how much time is needed in order to satisfy the Section 309(j)(3)(E)(ii) objectives as an *ad hoc* determination based on our expert assessment of all the factors, including the extent of the rule changes involved, the circumstances of the given auction and service at issue, the conditions of the market and the public needs during the general timeframe of the auction, and the potentially competing considerations of the other relevant statutory objectives in Section 309(j) (and in other applicable provisions) of the Communications Act. Rather than acknowledge this fact, the Joint Petitioners concoct a "standard practice" based solely on the Commission providing such a sixty-day period when it "established a uniform set of provisions for all auctionable services" by modifying rules governing status as a designated entity; governing auction application and payment issues; and governing competitive bidding design, procedure, and timing issues. *See* Amendment of Part 1 of the Commission's Rules—Competitive Bidding Procedures, *Third Report and Order and Second Further Notice of Proposed Rule Making* in WT Docket No. 97-82, 13 FCC Rcd 374, 377-79 (1997) (three page "executive summary"). The scope of the *Designated Entity Second Report and Order* is hardly so broad. Finally, we note again that Auction No. 66 is now scheduled to commence more than three months after release of the *Second Report and Order*.

rules are in place, they will be unable to participate in the auction. For example, while Bethel Native Corporation contends that it will be able to participate in Auction No. 66 if the new rules were no longer to apply to the licenses awarded in the auction, nowhere does it make a similar representation that it would be able to participate in Auction No. 66 if given a sufficient period of time to adjust to the new rules, which is not surprising given Joint Petitioners' claim that the new rules "have the practical effect of eviscerating a designated entity's access to capital."[20] Likewise, Council Tree claims: "[I]t will be virtually impossible as a practical matter to reconstruct or develop new business plans or financing alternatives for Designated Entities so long as the new rules are on the books. A mere postponement of the AWS auction is not sufficient under these circumstances."[21] As a result, it is apparent that the Joint Petitioners' real objection is to the substance of the new rules and not to questions of timing under section 309(j)(3)(E)(ii).

12. Additionally, it is important to note that section 309(j)(3) requires the Commission to balance several statutory objectives. As the Commission has previously stated, "while Section 309(j)(3)(E) directs the Commission to provide interested parties adequate time to prepare prior to an auction, the statute also requires that the Commission promote several other objectives in ex-

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[20] *Motion for Expedited Stay* at 4-5. As explained *infra*, the Commission strongly disagrees with this claim.

[21] *See* Declaration of Steve C. Hilliard, Council Tree Communications, Inc., at ¶ 8 (attached to *Further Supplement to Motion for Expedited Stay*). *See also Further Supplement to Motion for Expedited Stay* at 10 ("BNC's or Council Tree's circumstances would not and will not change until the FCC's rules change.").

ercising its competitive bidding authority, including the rapid deployment of new technologies and services to the public, promotion of economic opportunity and competition, recovery for the public of a portion of the value of the spectrum and avoidance of unjust enrichment, and efficient and intensive use of the spectrum."[22] Two of these other statutory objectives are of particular importance here: (1) promoting the development and rapid deployment of new technologies, products, and services public; and (2) avoiding unjust enrichment. We believe that these objectives impose on us here an obligation to avoid unnecessary or unreasonable delays of Auction No. 66. We have evidence that potential bidders have an immediate need for the licenses that will be offered in Auction No. 66[23] and that delaying the auction would impair the rapid deployment of affordable wireless service to the public.[24] Indeed, there is evidence in the record that suggests that delaying the auction further will impede the ability of smaller entities to successfully obtain licenses in Auction No. 66,[25] even though Joint Petitioners claim that our new rules will deter small businesses from participating in the auction. The alternative proposed by the Joint Petitioners of holding Auction No. 66 as currently scheduled but setting aside our new designated entity rules with respect to the licenses offered

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[22] Auction of Automated Maritime Telecommunications System Licenses Scheduled for August 21, 2005, *Public Notice*, 20 FCC Rcd 7811 (2005).

[23] *See, e.g* , T-Mobile Reply Comments at 4.

[24] *See, e g,*. Comments of T-Mobile USA, Inc., AU Docket No 06-3 at 2 (filed Feb. 14, 2006).

[25] Comments of Rural Telecommunications Group and Organization for the Promotion and Advancement of Small Telecommunications Companies at 6.

in that auction,[26] would put us in the position of neglecting our statutory duty to avoid unjust enrichment by assuring that designated entity benefits go to those entities that use their licenses to provide facilities-based services for the benefit of the public.[27] The additional alternative proposed by Joint Petitioners of delaying the auction to allow further comment on the rules adopted in the *Designated Entity Second Report and Order*[28] would constitute unreasonable delay in light of our statutory obligation to promote the development and rapid deployment of services for the benefit of the public. For all of these reasons, we continue to believe that we have reasonably balanced the objectives set forth in section 309(j)(3) and that proceeding with the auction as scheduled would best serve the public interest.

13. Finally, it is worth noting that Council Tree, in its comments in this proceeding, previously supported the Commission's proposal to apply new designated entity rules to the licenses offered in Auction No. 66.[29] And, at the same time, Council Tree took the position that Auction No. 66 should not be delayed.[30] When Council Tree made these comments, it was well aware of the general timeframe under which the Commission was

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[26] Petition for Expedited Reconsideration at 4-8.

[27] *See, e.g.*, Ex Parte of the U.S. Department of Justice at 4 (supporting the strengthening of designated entity rules due to the fact that designated entities in the past have not always been truly independent competitive actors).

[28] Further Supplement at 2.

[29] *See* Council Tree Comments at viii, 61-62. Petitioner Minority Media and Telecommunications Council also espoused this view. *See* Comments of Minority Media and Telecommunications Council at 7-8.

[30] *See id.* at 61.

operating, both with respect to this proceeding as well as the date of the auction. Indeed, recognizing the potentially tight time window at issue, Council Tree even urged the Commission, if necessary, to make the new designated entity rules effective immediately upon publication in the Federal Register, rather than with the normal thirty-day delay, so that the new rules could apply to the licenses offered in Auction No. 66, and the auction could be held on time.[31] And this was despite the fact that Council Tree was advocating even broader changes to the designated entity rules than those the Commission ultimately decided to adopt. In light of this history, we believe that Council Tree's current claim that the Commission has violated section 309(j)(3)(E)(ii) by applying the new designated entity rules to the licenses offered in Auction No. 66 and delaying the auction for over one month runs afoul of what the United States Court of Appeals for the District of Columbia Circuit has termed the "chutzpah doctrine."[32]

B. Material Relationships

14. *Notice.* In their Supplement, Joint Petitioners argue that we violated the Administrative Procedure Act[33] by adopting the new material relationship rules.[34]

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[31] *See id.* at 61.

[32] *See, e.g., Caribbean Shippers Ass'n, Inc. v. Surface Transp. Bd.*, 145 F.3d 1362 (D.C. Cir. 1998), *Harbor Ins. Co. v. Schnabel Found. Co.*, 946 F.2d 930, 937 & n.5 (D.C. Cir. 1991) (subcontractor asserted contractor was negligent for relying on subcontractor's advice).

[33] Supplement to Motion for Expedited Stay Pending Reconsideration or Judicial Review and Petition for Expedited Reconsideration at 9.

[34] Supplement to Motion for Expedited Stay Pending Reconsideration or Judicial Review and Petition for Expedited Reconsideration at 7-10.

They contend, first, that we failed to give sufficiently specific notice, and thus sufficient opportunity for comment, on the new restrictions on leasing and resale arrangements. Second, they argue that we made certain aspects of the rules immediately effective without the requisite statutory notice. We find both claims unconvincing.

15. It is settled that an agency "is not required to adopt a final rule that is identical to the proposed rule."[35] In fact, "[a]gencies are free—indeed, they are encouraged—to modify proposed rules as a result of the comments they receive."[36] If they were not free to do so, agencies "could learn from the comments on [their] proposals only at the peril of subjecting [themselves] to rulemaking without end."[37] As long as parties could have anticipated that the rule ultimately adopted was "possible," it is considered a "logical outgrowth" of the original proposal, and there is no violation of the APA's notice requirements.[38]

16. Applying these standards, it is clear that there was ample notice of the new material relationship rules in this case. The *Further Notice* emphasized the Commission's ongoing commitment "to prevent[ing] companies from circumventing the objectives of the designated entity eligibility rules"[39] and to ensuring that "its small business provisions [are] available only to bona fide

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[35] *Northeast Md Waste Disposal Auth. v. EPA*, 358 F 3d 936, 951 (D C. Cir. 2004)

[36] *Id.*

[37] *Id*

[38] *Id*

[39] *Further Notice* ¶ 6.

small businesses."[40] After discussing existing rules, we noted Council Tree's concern that those rules did "not adequately prevent large corporations from structuring relationships in a manner that allows them to gain access to benefits reserved for small businesses."[41] We then took note of Council Tree's specific proposal for addressing this concern, namely that designated entity benefits be withheld from any prospective licensee that has a "material relationship" with a "large, in-region incumbent wireless service provider."[42] While we tentatively proposed adoption of Council Tree's rule, we also sought comment "on whether other 'material relationships' . . . should trigger a restriction on the award of designated entity benefits."[43] Similarly, we asked whether limiting the prohibited "material relationships" to "large incumbent wireless service providers" or entities "with significant interests in communications services" would be "sufficient to address any concerns that

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[40] *Id.* ¶ 7

[41] *Id.* ¶ 12

[42] *Id.* ¶ 13.

[43] *Id.*; *see also id.* ¶ 19 (asking whether "additional entities" should be added to the list of those with which a designated entity may not have a "material relationship" without losing its status). We offered as an example of such a relationship one between "an otherwise qualified designated entity and an 'entity with significant interests in communications services.'" *Id.* ¶ 13. Our use of "such as" before this example makes clear that it was not the only one contemplated. In any event, insofar as the Commission sought comment on a far broader definition of the class of entities with whom a designated entity's material relationship might trigger the restriction of benefits, it should have been obvious to commenters that there was a possibility that an adopted restriction could apply to any relationships that the Commission deemed to be "material."

our designated entity program may be subject to potential abuse from larger corporate entities."[44]

17. In addition to contemplating a broad range of entities beyond the narrow category proposed by Council Tree, the *Further Notice* made clear that we were considering several approaches to defining a "material relationship." We noted that Council Tree proposed that a "material relationship" would exist based on, inter alia, "any material operational arrangement . . . (such as management, joint marketing, trademark, or other arrangements.)"[45] We did not tentatively propose adopting that definition, however, but instead broadly sought comment "on the specific nature of the relationship that should trigger such a restriction."[46]

18. Contrary to Council Tree's claim that it had no notice that an arrangement such as lease or resale could constitute a "material relationship," the *Further Notice* specifically contemplated it. We noted that in our Secondary Markets proceeding, we had concluded "that certain spectrum manager leases between a designated entity licensee and a non-designated entity lessee would cause the spectrum lessee to become an attributable affiliate of the licensee, thus rendering the licensee ineligible for designated entity benefits and making such a spectrum lease impermissible."[47] We then sought comment on whether we should follow a similar approach

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[44] *Further Notice* ¶ 15

[45] *Further Notice* ¶ 13.

[46] *Id.*

[47] *Id* ¶ 16. We noted that where "substantially all of the spectrum capacity of the licensee is to be leased" would effectively create an affiliate relationship between lessor and lessee, while lease of only "a small portion" of the capacity would not *See id* ¶ 16 n.38.

here: "We seek comment on what, if any, standard should be used to determine whether a spectrum leasing arrangement is a 'material relationship' for the purpose of any additional restriction on the availability of designated entity benefits that we might adopt."[48] We went on to ask "whether other arrangements should be taken into account" and "[i]f so, what arrangements should we consider?"[49]

19. The comments filed in response to the *Further Notice* reflected the broad scope of the questions posed there, and they ranged from those suggesting a complete overhaul of the Commission's designated entity eligibility rules to those recommending that we maintain the status quo.[50] Commenting parties clearly understood that the Commission was contemplating rule changes that would extend beyond material relationships with incumbent wireless carriers. For example, Dobson Communications Corporation noted that the Commission had sought comment "as to whether . . . restrictions should be placed on DEs that partner with other large companies that are not in-region wireless carriers."[51] Dobson urged the Commission to do so, arguing that "[i]f it is proven true that the benefits designed for small businesses are instead being realized by

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[48] *Id*

[49] *Id*

[50] *See, e.g.*, Comments of CTIA—The Wireless Association filed February 24, 2006; Comments of Verizon Wireless filed February 24, 2006; Comments of Cook Inlet Region, Inc. filed February 24, 2006; Comments of The Minority Media and Telecommunications Council filed February 24, 2006; Comments of National Hispanic Media Coalition filed February 24, 2006.

[51] Comments of Dobson Communications Corporation at 2 (filed February 24, 2006).

large strategic investors, it surely should not matter whether that investor is an in-region incumbent wireless service provider or not."[52] Council Tree, on the other hand, argued that the prohibition should remain narrowly circumscribed to only large incumbent wireless carriers.[53] Likewise, parties clearly understood that arrangements such as spectrum leases could constitute "material relationships" and commented on the subject.[54]

20. Based on a review of those comments, and given our experience in awarding designated entity benefits, we determined that we should modify our rules to achieve Congress's objectives of preventing unjust enrichment and promoting true participation by designated entities in the provision of spectrum-based services for the benefit of the public. We concluded that "certain agreements" between designated entities and others are "by their very nature . . . generally inconsistent with Congress's legislative intent," regardless of what other kind of entity they involve.[55] Specifically, we explained that "where an agreement concerns the actual use of the designated entity's spectrum capacity, it is the agree-

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[52] *Id*

[53] Comments of Council Tree Communications, Inc. at 35-41 (filed February 24, 2006).

[54] *See, e.g*, Comments of MMTC at 6 & n 16 (discussing spectrum lease and resale arrangements as examples of entities "manipulating the [DE] program"); Comments of Council Tree filed February 24, 2006, at 50 ("material operating arrangement" should cover all arrangements other than "non-discriminatory roaming" agreement or "short-term de facto transfer leasing arrangement"); Reply Comments of Council Tree filed March 3, 2006, at 31 (discussing resale arrangements between DEs and incumbent wireless carriers).

[55] *Designated Entity Second Report and Order* ¶ 23.

ment, as opposed to the party with whom it is entered into, that causes the relationship to be ripe for abuse and creates the potential for the relationship to impede a designated entity's ability to become a facilities-based provider, as intended by Congress."[56] Accordingly, we adopted rules in the *Designated Entity Second Report and Order* to limit the award of designated entity benefits to any applicant or licensee that has "impermissible material relationships" or an "attributable material relationship" created by agreements with one or more other entities for the lease or resale (including under a wholesale arrangement) of its spectrum capacity.

21. These rules were a logical outgrowth of the questions we asked in the *Further Notice* and are well within the scope of the inquiry initiated there. The fact that we elected to adopt a definition of material relationship that differed from that specifically proposed by Council Tree does not mean that we failed to provide notice of the rule modifications we ultimately adopted. We therefore reject Joint Petitioners' APA notice claim regarding the material relationship rules.

22. Second, we also disagree with the Joint Petitioners' contention that we made certain aspects of the rules immediately effective and find that such an argument is based on a gross misreading of the rule. The reference to the date of the release in the new rule did not impose any consequences on parties immediately following the date of release. Rather, once the rules became effective—30 days after Federal Register publication—actions taken following the release might affect a party's status, but only if not undone in the period before the

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[56] *Designated Entity Second Report and Order* ¶ 23.

rule became effective. Thus, parties had the requisite period of notice to adjust in response to the new rule.

23. *Requests for General Clarification.* In addition to the arguments raised by the Petitioners, after releasing the *Designated Entity Second Report and Order* staff received a number of questions seeking general advice regarding how the Commission intended to implement its rule modifications. We therefore clarify how we will consider: (1) the meaning of "spectrum capacity" in the context of material relationships, (2) grandfathering, and (3) applicability of the rules to particular services.

24. *Material Relationships.* A number of questions have been raised regarding how the Commission will evaluate impermissible and attributable material relationships for the purposes of determining eligibility for both designated entity benefits and the imposition of unjust enrichment. In the *Designated Entity Second Report and Order*, we concluded that an applicant or licensee has "impermissible material relationships" when it has agreements with one or more other entities for the lease (under either spectrum manager or *de facto* transfer leasing arrangements) or resale (including under a wholesale arrangement) of, on a cumulative basis, more than 50 percent of the spectrum capacity of any individual license. We decided that such "impermissible material relationships" would render the applicant or licensee (i) ineligible for the award of future designated entity benefits, and (ii) subject to unjust enrichment on a license-by-license basis. We further concluded that an applicant or licensee has an "attributable material relationship" when it has one or more agreements with any individual entity, including entities and individuals

attributable to that entity, for the lease (under either spectrum manager or *de facto* transfer leasing arrangements) or resale (including under a wholesale arrangement) of, on a cumulative basis, more than 25 percent of the spectrum capacity of any individual license that is held by the applicant or licensee. We decided that such an "attributable material relationship" would be attributed to the applicant or licensee for the purposes of determining the applicant's or licensee's (i) eligibility for future designated entity benefits, and (ii) liability for unjust enrichment on a license-by-license basis. As stated in the *Designated Entity Second Report and Order*, the Commission's policy is to assure that a designated entity preserves at least half of the spectrum capacity of each license for which the designated entity has been awarded and retained designated entity benefits in exchange for the provision of service as a facilities-based provider for the benefit of the public.[57]

25. *Meaning of Spectrum Capacity.* We also take this opportunity to clarify how we will measure compliance with the thresholds we adopted in our definitions of material relationships. The restrictions we adopted regarding impermissible and attributable material relationships require a designated entity to assess the percentage of its spectrum capacity that will be leased (under either spectrum manager or *de facto* transfer leasing arrangements) or subject to resale (including under a wholesale arrangement). Since release of the *Designated Entity Second Report and Order*, parties have asked us to clarify the meaning of "spectrum capacity." Accordingly, we provide additional guidance on deter-

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[57] *Designated Entity Second Report and Order* at ¶ 27.

mining the percentage of a designated entity's spectrum capacity involved in lease or resale agreements.

26. We observe, as an initial matter, that there are a number of ways "spectrum capacity" could be defined. It would be difficult for the Commission to enumerate every possible means by which a licensee could lease or make its spectrum capacity available to another party to resell. By adopting "spectrum capacity" as a measurement, we sought to provide licensees with some flexibility to tailor their agreements to their business needs. We thus are reluctant to employ only a single measure of "spectrum capacity." Nevertheless, to assist designated entities as they evaluate secondary market transactions, we clarify that if they meet the spectrum capacity thresholds on a MHz * pops basis, the Commission will find them in compliance. The MHz * pops basis is consistent with the Commission's current method of apportioning unjust enrichment when licenses are partitioned and/or disaggregated and provides a meaningful measure here.[58] However, while meeting the spectrum capacity thresholds on a MHz * pops basis is sufficient to comply with our rules, it is not the only means of compliance. In other words, any entity meeting the thresholds on a MHz * pops basis will be found in compliance, but entities not meeting the thresholds on a MHz * pops basis may also be found in compliance based on other factors. The MHz * pops measure is intended as a safe harbor; it is not meant to limit complying with the rules in other ways that we cannot fully anticipate at this time. We recognize that our decision not to enumerate all other means of compliance necessarily leaves some uncertainty, but we think that the MHz * pops safe har-

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[58] *See* 47 C.F.R. §1.2111(e).

bor provides sufficient certainty while allowing licensees and the Commission flexibility to conduct a more contextual analysis.

27. *Grandfathering.* In the *Designated Entity Second Report and Order*, we explained that we would not employ our new restrictions to reconsider the eligibility for any designated entity benefits that had been awarded to licensees prior to the April 25, 2006, release date of the decision or to determine eligibility for designated entity benefits in an application for a license, an authorization, or an assignment or transfer of control, or a spectrum lease that had been filed with the Commission before, and was still pending approval on, that date.

28. We received a number of inquiries regarding how the Commission will consider future agreements that were "agreed upon" prior to the release date of our decision. We therefore offer the following explanation. Agreements entered into by a designated entity—and, to the extent required, approved by or pending approval by the Commission—no later than April 24, 2006 that concern the lease or resale of the designated entity's spectrum capacity after the release date of the *Designated Entity Second Report and Order* are grandfathered for the purposes of existing eligibility benefits and the imposition of unjust enrichment to the extent that the designated entity has no discretion as to the future lease or resale. For example, if a designated entity licensee had entered into an agreement on or before April 24, 2006 pursuant to which it was required to make 26 percent of its spectrum capacity available to Company B for resale purposes in 2007, that agreement would be grandfathered and therefore would not affect the licensee's eligibility for existing designated entity benefits

for that license nor would it trigger any future unjust enrichment obligations for that license. Even though Company B could not begin reselling the designated entity's spectrum until 2007, its unequivocal right to do so had been contractually established before the release date of the *Designated Entity Second Report and Order*.[59]

29. If, however, the agreement allowed the designated entity to decide at some future point in time whether it would make spectrum available to Company B for resale purposes, and the designated entity did not legally commit itself to the resale until after April 24, 2006, the agreement for resale would, on the date the designated entity made the legal commitment, give rise to an attributable material relationship and also would be considered in calculating whether the designated entity had entered into impermissible material relationships.[60] Accordingly, the agreement might have implications for the designated entity's ongoing eligibility for designated entity benefits for that license and unjust enrichment obligations. This result would occur even if the agreement had, prior to the release date of the *Designated Entity Second Report and Order*, already been reviewed and approved by the Commission. Thus, the applicability of grandfathering to the future lease or resale of spectrum in a pre-existing agreement depends on whether or not the provision was a "done deal" such

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[59] The agreement would still count toward any assessment of whether the designated entity retained a controlling interest in the license, however.

[60] We note that the designated entity would not be able to make this legal commitment without the advance approval of the Commission. *See* 47 C.F.R. § 1.2114.

that, prior to April 25, 2006, the decision to lease or to allow the resale of spectrum was no longer within the discretion of the designated entity.[61]

30. *Applicability of Material Relationships Rules to Certain Services.* There has also been some question about the applicability of the new material relationship rules with regard to agreements to lease spectrum in the 700 MHz Guard Band Manager Service and those other services not covered by our secondary market leasing policies.[62] Consequently, we clarify that the new material relationship rules will apply only to those services in which leasing is permitted under our secondary markets rules.[63]

C. Unjust Enrichment

31. *Notice.* In their petition for expedited reconsideration of the *Designated Entity Second Report and*

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[61] This analysis is analogous to the one we use for evaluating whether the future ownership interests of a designated entity's investor are to be treated as "fully diluted" and thus immediately attributable to the designated entity. *See Competitive Bidding Fifth MO&O*, 10 FCC Rcd at 454-56, ¶¶ 93-96.

[62] *See* Promoting Efficient Use of Spectrum through Elimination of Barriers to the Development of Secondary Markets, WT Docket No. 00-230, *Second Report and Order, Order on Reconsideration, and Second Further Notice of Proposed Rulemaking*, 19 FCC Rcd 17503, 17528-36 ¶¶ 51-66 (2004) ("*Secondary Markets Second Report and Order*").

[63] *See* 47 C.F.R. § 1.9005; Promoting Efficient Use of Spectrum Through Elimination of Barriers to the Development of Secondary Markets, *Report and Order and Further Notice of Proposed Rulemaking*, 18 FCC Rcd 20604 (2003) (*Report and Order* and *Further Notice*, respectively), *Erratum*, 18 FCC Rcd 24817 (2003); *Secondary Markets Second Report and Order*, 19 FCC Rcd 17503 (2004).

Order, the Joint Petitioners argue that the Commission violated the Administrative Procedure Act by giving inadequate notice and opportunity for comment prior to adopting new unjust enrichment provisions.[64] This claim is refuted by the plain language of the *Further Notice* and by the Joint Petitioners' own filings in response to it.

32. In the *Further Notice*, we observed that the Commission's existing rules "require the payment of unjust enrichment when an entity that acquires its license with small business benefits loses its eligibility for such benefits or transfers a license to another entity that is not eligible for the same level of benefits."[65] We also noted that Council Tree had proposed extending this "reimbursement obligation" to any licensee that acquires a license with the help of a bidding credit but then "makes a change in its 'material relationships' or seeks to assign or transfer control of the license to an entity that would result in its loss of eligibility for the bidding credit pursuant to any eligibility restriction that we adopt."[66] According to Council Tree, strengthening the unjust enrichment rules was "necessary to fulfill the Commission's statutory obligation to prevent unjust enrichment."[67] The *Further Notice* sought comment both on Council Tree's specific proposal and on whether we should seek to strengthen the unjust enrichment rules

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[64] Petition for Expedited Reconsideration at 18-22. These parties also argue that the Commission released its new unjust enrichment provisions too close to the short-form application deadline for Auction No. 66. *Id.* at 5-6.

[65] *Further Notice* at ¶ 20.

[66] *Id.*

[67] *Id.*, *see* 47 U.S.C. § 309(j)(4)(E); 47 C.F.R. § 1.2111(d).

"in some other manner."[68] We also asked a series of questions about the scope of the reimbursement obligation, seeking comment on whether it should be triggered only "where the licensee takes on new investment" or also when it "enters into any new 'material financial relationship' or 'material operational relationship' that would have rendered the licensee ineligible for a bidding credit."[69] Finally, while we noted Council Tree's proposal for a five-year reimbursement obligation, we did not even tentatively propose adopting it; instead, we asked "over what portion of the license term should . . . unjust enrichment provisions apply?"[70]

33. Notwithstanding the broad scope of the questions asked by the *Further Notice*, Council Tree claims that parties had no notice that we were contemplating any changes to our unjust enrichment rules other than those specifically proposed by Council Tree. As the above discussion of the *Further Notice* makes clear, we did not put ourselves in such a straitjacket, and it would have been unreasonable for any party to believe that we had done so. Nowhere did we say we would consider only a five-year reimbursement obligation or that we would artificially limit the rule changes only to relationships with particular entities.

34. Indeed, the comments filed in response to the *Further Notice* demonstrate that parties did in fact understand the scope of the contemplated changes to the unjust enrichment rules. Council Tree itself squarely acknowledged that "[t]he Commission also seeks com-

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[68] *Further Notice* at ¶ 20.

[69] *Id*

[70] *Id*

ment regarding over what portion of the license term should the unjust enrichment provisions apply."[71] Council Tree went on to advocate retention of a five-year time period.[72] On the other hand, MMTC, another of the Joint Petitioners now claiming lack of notice, urged "the Commission [to] consider expanding the unjust enrichment standard to encompass the entire license term and not just the first five years."[73] MMTC also suggested that the Commission consider adjusting its reimbursement obligations to require repayment of 100 percent of the value of the bidding credit.[74] Similarly, STX supported "stricter unjust enrichment rules so that the U.S. Treasury may be made whole in the event that a designated entity turns out to have been merely a front organized to secure bidding credits for a large incumbent wireless service provider."[75]

35. The changes we ultimately adopted to our unjust enrichment rules were clearly within the scope of the revisions contemplated by the *Further Notice* or, at a minimum, a logical outgrowth of them. Indeed, had we only revised the five-year unjust enrichment schedule

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[71] Comments of Council Tree at 58 (citing the *Further Notice* at ¶ 20).

[72] *Id.*

[73] *Designated Entity Second Report and Order*, FCC 06-52, at ¶ 35, referencing the Comments of MMTC at 15. Without explanation, MMTC proposed that the Commission adopt such a change in its unjust enrichment rules only after "initiating a [new] inquiry," *i.e.* rule making. MMTC expressly acknowledged, however, that in the *Further Notice* "[t]he Commission asks whether it should expand the scope of its unjust enrichment rules[.]" Given acknowledgement of this request, it is unclear why MMTC sought a further proceeding to adopt its proposal.

[74] *Id.*

[75] *Designated Entity Second Report and Order*, FCC 06-52, at ¶ 35, referencing the Comments of STX at 2.

for certain types of transactions but not for others, we would have risked creating an illogical scheme that would have created an incentive for designated entities to prioritize certain types of transactions over others. For all of these reasons, we reject the Joint Petitioner's APA notice claim.

36. *Impact of New Rules.* In the *Designated Entity Second Report and Order*, we adopted changes to our unjust enrichment rules to ensure that designated entity benefits go to their only intended beneficiaries.[76] We agreed with commenters that the adoption of stricter unjust enrichment rules would increase the probability that the designated entity would develop into a competitive facilities-based service provider and deter speculation by those who do not intend to offer service to the public, or who intend to use bidding credits to obtain a license at a discount and later to sell it at the full market price for a windfall profit.[77]

37. We therefore modified our unjust enrichment rules to expand the unjust enrichment payment schedule from five to ten years.[78] Further, we required that the Commission be reimbursed for the entire bidding credit amount owed if a designated entity loses its eligibility for a bidding credit prior to the filing of the applicable construction notifications.[79] Specifically, we adopted the

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[76] *See Designated Entity Second Report and Order*, FCC 06-52, at ¶ 31; *see also* 47 C.F.R. § 1.2111(b)-(e).

[77] *See Designated Entity Second Report and Order*, FCC 06-52, at ¶ 36.

[78] *See Designated Entity Second Report and Order*, FCC 06-52, at ¶ 37.

[79] *See Designated Entity Second Report and Order*, FCC 06-52, at ¶ 38.

following ten-year unjust enrichment schedule for licenses acquired with bidding credits. For the first five years of the license term, if a designated entity loses its eligibility for a bidding credit for any reason,[80] including but not limited to, entering into an "impermissible material relationship" or an "attributable material relationship," seeking to assign or transfer control of a license, or entering into a *de facto* transfer lease with an entity that does not qualify for bidding credits, 100 percent of the bidding credit, plus interest, is owed.[81] For years six and seven of the license term, 75 percent of the bidding credit, plus interest, is owed.[82] For years eight and nine, 50 percent of the bidding credit, plus interest, is owed, and for year ten, 25 percent of the bidding credit, plus interest, is owed.[83] We also imposed a requirement that the Commission must be reimbursed for the entire bidding credit amount owed, plus interest, if a designated entity loses its eligibility for a bidding credit for any

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[80] *See Designated Entity Second Report and Order*, FCC 06-52, at ¶ 46, n.116 (discussing additional events that could result in a possible loss of designated entity eligibility).

[81] *Designated Entity Second Report and Order*, FCC 06-52, at ¶ 37.

[82] *Id.*

[83] *Id.* If a designated entity loses its eligibility for the same level of bidding credit that it originally received for any reason, this unjust enrichment schedule will be applied to the difference between the original bidding credit and the bidding credit for which the designated entity, assignee, or assignor is eligible. *See id.* We also noted that the provisions of section 1.2112(e) of the Commission's rules may also apply. *See id.* n.106 (citing 47 C.F.R. § 1.2112(e) (discussing the assessment of unjust enrichment in the context of the partition and/or disaggregation of licenses)).

reason,[84] including but not limited to, entering into an "impermissible material relationship" or an "attributable material relationship," seeking to assign or transfer control of a license, or entering into a *de facto* transfer lease with an entity that is not eligible for bidding credits prior to the filing of the notification informing the Commission that the construction requirements applicable at the end of the license term have been met.[85]

38. Joint Petitioners assert that the new provisions will eliminate designated entities' access to capital and financing. For several reasons, these claims do not justify reconsideration of the recent rule changes.

39. First, Joint Petitioners contend that the new unjust enrichment rules "have the practical effect of eliminating a designated entity's access to capital by closing an accepted exit path if the business is not going well."[86] This is so because, according to Joint Petitioners, "private equity and other investors frequently adhere to three to seven year investment horizons, with five being an accepted average."[87] Joint Petitioner's

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[84] *Designated Entity Second Report and Order*, FCC 06-52, at ¶ 46, n.116 (discussing additional events that could result in a possible loss of designated entity eligibility).

[85] *Designated Entity Second Report and Order*, FCC 06-52, at ¶ 38. For example, if a designated entity seeks to assign a license with a bidding credit to an entity that is not eligible for bidding credits eight years after the grant of the license and prior to the filing of the construction notification, 100 percent of the bidding credit, plus interest, will be owed, rather than the 50 percent unjust enrichment payment that would have been due had the construction notification been on file with the Commission, pursuant to the revised unjust enrichment schedule, above. *Id.*

[86] Petition for Expedited Reconsideration at 3-4.

[87] Petition for Expedited Reconsideration at 10.

assertions regarding "accepted averages" do not demonstrate, however, that designated entities access to capital will be eliminated. Indeed, we are not convinced that three to seven years is a reasonable timeframe for investors to expect to recover their capital investments in facilities to provide spectrum-based services. In a recently concluded proceeding addressing the leasing of Educational Broadcast Service spectrum, a broad crosssection of commenters, including a private equity investment firm,[88] submitted evidence that insufficient capital would flow to businesses that want to develop that spectrum if the length of spectrum lease terms was limited to fifteen years.[89] These parties argued that lessees needed access to the spectrum for thirty years or more in order to provide the necessary certainty to justify capital investment in the band.[90] The Commission was "persuaded by the analyses presented by commenters indicating the difficulty that commercial lessees may have in obtaining financing if leases are limited to a shorter duration" than thirty years.[91] Given our recent

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[88] Ex parte Letter from James N. Perry, Jr., Managing Director for Madison Dearborn Partners, LLC to Marlene H Dortch, Federal Communications Commission (dated March 31, 2006) in WT Docket No. 03-66 at 1.

[89] *See, e.g.*, Amendment of Parts 1, 21, 73, 74 and 101 of the Commission's Rules to Facilitate the Provision of Fixed and Mobile Broadband Access, Educational and Other Advanced Services in the 2150-2162 and 2500-2690 MHz Bands, WT Docket No. 03-66, *Third Memorandum Opinion and Order*, FCC 06-46 (rel. April 27, 2006), at ¶¶ 258-60 (comments of Madison Dearborn Partners, Inc., various schools and universities, George Mason University Instructional Foundation, Inc.).

[90] Nextel Opposition to Petition for Reconsideration in WT Docket No. 03-66 at 18-19.

[91] *See, generally*, Amendment of Parts 1, 21, 73, 74 and 101 of the Commission's Rules to Facilitate the Provision of Fixed and Mobile

finding that access to Educational Broadcast Service spectrum for longer than fifteen years is essential to attract the capital needed to deploy facilities for spectrum based services, we are not convinced that the appropriate investment horizon for designated entity status should be only three to seven years.[92] Designated entity benefits are offered to ensure that small businesses have an opportunity to participate in the provision of spectrum-based services, not to ensure the short-term "exit strategies" of parties providing capital. The Commission strengthened its rules to ensure that those that receive such benefits were properly motivated to build out their spectrum and provide services for the benefit of the public by closing off the opportunity to sell licenses awarded with bidding credits for huge profits without ever having to provide actual facilities based services. The Joint Petitioners' predictions regarding the new rules' effect on venture capital alone are not a basis for reconsidering the rules.

40. Second, even if some sources of financing and capital would no longer be available on the same terms as before, the adoption of new rules is not arbitrary and capricious, or otherwise contrary to law. The Commission must balance the various statutory objectives of Section 309(j), and based on the record in response to the *Further Notice* and many years of experience, we

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Broadband Access, Educational and Other Advanced Services in the 2150-2162 and 2500-2690 MHz Bands, WT Docket No. 03-66, *Third Memorandum Opinion and Order*, FCC 06-46 (rel. April 27, 2006), ¶268 (permitting EBS licensees to enter into leases with terms of up to 30 years based on "analyses presented by commenters indicating the difficulty that commercial lessees may have in obtaining financing if leases are limited to a shorter duration").

[92] *Id.*

found that the new unjust enrichment rules are necessary to increase the probability that designated entities will develop into facilities-based providers of service for the benefit of the public.[93] Again, it is neither the Commission's statutory responsibility nor its intent merely to provide small businesses with generalized economic opportunities in connection with spectrum licenses.[94] The Commission has not been charged with providing entities with a path to financial success, but rather with an obligation to facilitate opportunities for small businesses to provide spectrum based services to the public.[95] Therefore, it is our responsibility to create strong incentives for designated entities to use spectrum to provide facilities-based service to the public instead of holding their licenses and selling them for profit. We believe that our new rules create appropriate incentives in this regard while still affording designated entities the opportunity to achieve financial success by providing service to the public. It is important to remember that designated entities are provided with bidding credits in order to enable them to obtain spectrum and then provide facilities-based service to the public. To the extent that they do not do so, but instead sell their licenses to others in the marketplace at market prices, we believe that it is reasonable that they no longer be allowed to enjoy the benefit of obtaining spectrum at below-market prices.

41. *Clarification.* We believe that clarification is warranted of our statement in the *Designated Entity*

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[93] *See Designated Entity Second Report and Order*, FCC 06-52, at ¶ 36.

[94] *Secondary Markets Second Report and Order* at ¶ 70.

[95] *See id*

Second Report and Order that "retroactive penalties [will] not be imposed on preexisting designated entities."[96] Specifically, we clarify that the newly-adopted ten-year unjust enrichment schedule applies only to licenses that are granted after the release of the *Designated Entity Second Report and Order*.[97] Likewise, the requirement that the Commission be reimbursed for the entire bidding credit amount owed if a designated entity loses its eligibility for a bidding credit prior to the filing of the notifications informing the Commission that the construction requirements applicable at the end of the license term have been met applies only to those licenses that are granted on or after the April 25, 2006 release date of the *Designated Entity Second Report and Order*. We also make corresponding corrections to section 1.2111 of our rules.[98]

D. Review of Agreements, Annual Reporting Requirements, and Audits

42. We also take this opportunity to clarify and emphasize certain aspects of section 1.2114, our newly-adopted rule relating to reportable eligibility events.[99] As the rule expressly states, "[a] designated entity must seek Commission approval for all reportable eligibility events."[100] As discussed in the *Designated Entity Sec-*

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[96] *Designated Entity Second Report and Order*, FCC 06-52, at ¶ 41.

[97] *See* Letter from Carl W. Northrop, counsel for Salmon PCS, LLC, to Marlene H. Dortch, Secretary, FCC, WT Docket No. 05-211 (filed May 11, 2006).

[98] *See* Rules Appendix

[99] 47 U.S.C § 1.2114.

[100] 47 C.F.R. § 1.2114(a)

ond Report and Order,[101] we emphasize that section 1.2114 requires prior Commission approval for a reportable eligibility event. We also clarify that a reportable eligibility event includes any event that might affect a designated entity's ongoing eligibility, under either our material relationship or controlling interest standards,[102] and we correct new section 1.2114(a) accordingly. Although we affirm that we have delegated authority to the Wireless Telecommunications Bureau ("Bureau") to implement our rule changes on reporting,[103] we anticipate that the Bureau's procedures will provide the means by which parties will apply for approval of all such arrangements. Such approval may require modifications to the terms of the parties' arrangements or unjust enrichment payments based on the impact of such arrangements on designated entity eligibility. We also take this opportunity to affirm our conclusions in the *Designated Entity Second Report and Order* with regard to the implementation of our regulations relating to the review of long-form applications and agreements to determine designated entity eligibility under the controlling interest standard. We also affirm our event-based and annual reporting requirements as well as our commitment to audit the eligibility of every designated entity that wins a license in the AWS auction at least once during the initial term.[104]

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[101] *See Designated Entity Second Report and Order*, FCC 06-52, at ¶ 46, note 115 and accompanying text.

[102] *See Designated Entity Second Report and Order*, FCC 06-52, at ¶ 47, note 116 and accompanying text.

[103] *See Designated Entity Second Report and Order*, FCC 06-52, at ¶ 48.

[104] *See Designated Entity Second Report and Order*, FCC 06-52, at ¶¶ 42-50.

E. Regulatory Flexibility Act

43. We also disagree with the claims of the Joint Petitioners that our recently adopted rules violate the Regulatory Flexibility Act ("RFA").[105] Among other things, the Joint Petitioners assert that we failed to provide adequate notice in the Initial Regulatory Flexibility Analysis ("IRFA") about the scope of the proposed rules, their application to current designated entity licensees, or the ten-year unjust enrichment schedule for licenses acquired with bidding credits. We note as an initial matter that the IRFA is not subject to judicial review. Section 611 of the RFA expressly prohibits courts from considering claims of non-compliance with the initial regulatory flexibility analysis requirement of RFA section 603.[106] Moreover, Joint Petitioners have not articulated the legal basis for their claim that a purported lack of notice constitutes an independent violation of the RFA. In any case, we have demonstrated above that the *Further Notice* (the substance of which was incorporated by reference in the IRFA) provided ample notice of the possible rule changes at issue here.[107] For the same reason, any claim about the sufficiency of

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[105] *See* Supplement of Council Tree, MMTC and Bethel Native at 3-7.

[106] 5 U.S.C. §§ 603, 611(a),(c). *See United States Cellular Corporation v FCC*, 254 F.3d 78 (D C. Cir. 2001); *Allied Local & Regional Mfrs Caucus v EPA*, 215 F.3d 61, 79 (D.C. Cir. 2000).

[107] *See Further Notice*, Initial Regulatory Flexibility Analysis, 21 FCC Rcd 1753 (2006) We also note that one of Joint Petitioners' primary claims—that retroactive application of the unjust enrichment rules violates the RFA—has been rendered moot by this *Order on Reconsideration*, which clarifies that the ten-year unjust enrichment schedule applies only to licenses initially granted to designated entities after April 25, 2006.

the Final Regulatory Flexibility Analysis ("FRFA") based on charges of inadequate notice and lack of opportunity for comment is also without merit.

44. We also disagree with the claims of the Joint Petitioners that we failed to describe significant alternatives to the rules we adopted in order to minimize any significant economic impact on small entities as required by the RFA. The Final Regulatory Flexibility Analysis ("FRFA") in the *Second Report and Order* referred to the substantive part of the Order, which discussed in great depth the impact of the rules on small businesses, alternatives considered, and why the Commission adopted the rules at issue. Reiteration of the discussion of the impact on small businesses in the FRFA is not required by the RFA,[108] and such reiteration would have been repetitive here, as analyses of alternatives related to small businesses infuse the decision. In adopting our rule modifications to better achieve Congress's plan, we fully explained that we were finding a "reasonable balance between the competing goals of first, providing designated entities with reasonable flexibility in being able to obtain needed financing from investors and, second, ensuring that the rules effectively prevent entities ineligible for designated entity benefits from circumventing the intent of the rules by obtaining those benefits indirectly, through their investments in qualified businesses."[109] Consistent with previous changes we

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[108] 108 *See* 5 U S.C § 605(a) ("Any Federal agency may perform the analyses required by sections 602, 603, and 604 of this title in conjunction with or as a part of any other agenda or analysis required by any other law if such other analysis satisfies the provisions of such sections.").

[109] *See Designated Entity Second Report and Order*, FCC 06-52, at ¶ 8.

have made to our designated entity rules, the rule modifications at issue were the result of trying to maintain this balance in "the face of a rapidly evolving telecommunications industry, legislative changes, judicial decisions, and the demand of the public for greater access to wireless services."[110] Moreover, as evidenced by the expansive record compiled in this docket and our decision to defer the adoption of further rules, if any, until after we had provided additional opportunity for parties to comment, we adopted only those rules that we concluded were clearly warranted to deter abuse of the Commission's designated entity program.[111] Consequently, we believe that our analysis fully complied with the requirements of the RFA.[112]

IV. CONCLUSION

45. For all of the reasons set forth above, we clarify certain aspects of the *Second Report and Order* as well as our rules for determining the eligibility of applicants for size-based benefits in the context of competitive bidding.

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[110] *Id*

[111] *See Designated Entity Second Report and Order*, FCC 06-52, at ¶ 23.

[112] *United States Cellular Corporation v FCC*, 254 F.3d 78 (D.C. Cir 2001)(holding that "[p]urely procedural . RFA section 604 requires nothing more than that the agency file a FRFA demonstrating a 'reasonable good faith effort to carry out [RFA's] mandate.' *Alenco Communications, Inc. v. FCC*, 201 F.3d 608, 625 (5th Cir. 2000).").

V. PROCEDURAL MATTERS

A. Paperwork Reduction Act Analysis

46. This document does not contain proposed information collection(s) subject to the Paperwork Reduction Act of 1995 (PRA), Public Law 104-13. In addition, therefore, it does not contain any new or modified "information collection burden for small business concerns with fewer than 25 employees," pursuant to the Small Business Paperwork Relief Act of 2002, Public Law 107-198, *see* 44 U.S.C. 3506(c)(4).

B. Congressional Review Act

47. The Commission will include a copy of this Order on Reconsideration of the Second Report and Order in a report it will send to Congress and the Government Accountability Office pursuant to the Congressional Review Act, *see* 5 U.S.C. 801(a)(1)(A).

C. Effective Date

48. This Order on Reconsideration of the Second Report and Order and the accompanying rule changes are effective upon publication in the Federal Register. We find there is good cause under section 553(d)(3) of the Administrative Procedure Act[113] to make the changes we implement with this Order effective upon Federal Register publication, without the usual 30-day period, because these changes (with the possible exception of those concerning the unjust enrichment rules) constitute minor points of clarification of the rules adopted in the Designated Entity Second Report and Order, which

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[113] 5 U.S.C §553(d).

were published in the Federal Register on May 4, 2006.[114] As to the clarifying changes in our unjust enrichment rules,[115] these changes, at most, serve to "grant[ ] or recognize[ ] an exemption or relieve[ ] a restriction" and would therefore fall within the exception contained in section 553(d)(1).[116]

VI. ORDERING CLAUSE

49. IT IS ORDERED that pursuant to the authority granted in Sections 4(i), 5(b), 5(c)(1), 303(r), and 309(j) of the Communications Act of 1934, as amended, 47 U.S.C. §§ 154(i), 155(b), 155(c)(1), 303(r), and 309(j), this Order on Reconsideration of the Second Report and Order, is hereby ADOPTED and Part 1, Subpart Q of the Commission's rules are amended as set forth in the Appendix, effective upon the publication of this Order on Reconsideration in the Federal Register.

FEDERAL COMMUNICATIONS COMMISSION

Marlene H. Dortch
Secretary

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[114] 71 Fed. Reg. 26,245, May 4, 2006.

[115] 47 C.F.R. § 1.2111 as revised herein.

[116] 5 U.S.C. § 553(d)(1).

APPENDIX

Final Rules

For the reasons discussed in the preamble, the Federal Communications Commission amends 47 CFR part 1 as follows:

PART 1 – PRACTICE AND PROCEDURE

For the reasons discussed in the preamble, the FCC amends part 1 of the Code of Federal Regulations to read as follows:

1. The authority citation for part 1 continues to read as follows:

Authority: 15 U.S.C. 79 *et seq.*; 47 U.S.C. 151, 154(i), 154(j), 155, 157, 225, 303(r), and 309.

2. Revise paragraphs (a), (b) introductory text, and (d)(2) of § 1.2111 to read as follows:

§ 1.2111 Assignment or transfer of control: unjust enrichment.

(a) Reporting requirement. An applicant seeking approval for a transfer of control or assignment (otherwise permitted under the Commission's rules) of a license within three years of receiving a new license through a competitive bidding procedure must, together with its application for transfer of control or assignment, file with the Commission a statement indicating that its license was obtained through competitive bidding. Such applicant must also file with the Commission the associated contracts for sale, option agreements, management agreements, or other documents disclosing the local consideration that the applicant would receive in return for

the transfer or assignment of its license (see § 1.948). This information should include not only a monetary purchase price, but also any future, contingent, in-kind, or other consideration (e.g., management or consulting contracts either with or without an option to purchase; below market financing).

(b) Unjust enrichment payment: set-aside. As specified in this paragraph an applicant seeking approval for a transfer of control or assignment (otherwise permitted under the Commission's rules) of, or for entry into a material relationship (see §§ 1.2110, 1.2114) (otherwise permitted under the Commission's rules) involving, a license acquired by the applicant pursuant to a set-aside for eligible designated entities under § 1.2110(c), or which proposes to take any other action relating to ownership or control that will result in loss of eligibility as a designated entity, must seek Commission approval and may be required to make an unjust enrichment payment (Payment) to the Commission by cashier's check or wire transfer before consent will be granted. The Payment will be based upon a schedule that will take account of the term of the license, any applicable construction benchmarks, and the estimated value of the set-aside benefit, which will be calculated as the difference between the amount paid by the designated entity for the license and the value of comparable non-set-aside license in the free market at the time of the auction. The Commission will establish the amount of the Payment and the burden will be on the applicants to disprove this amount. No Payment will be required if:

* * * * *

(d) * * *

(2) Payment schedule.

(i) For licenses initially granted after April 25, 2006, the amount of payments made pursuant to paragraph

(d)(1) of this section will be 100 percent of the value of the bidding credit prior to the filing of the notification informing the Commission that the construction requirements applicable at the end of the initial license term have been met. If the notification informing the Commission that the construction requirements applicable at the end of the initial license term have been met, the amount of the payments will be reduced over time as follows:

(A) A loss of eligibility in the first five years of the license term will result in a forfeiture of 100 percent of the value of the bidding credit (or in the case of eligibility changing to qualify for a lower bidding credit, 100 percent of the difference between the bidding credit received and the bidding credit for which it is eligible);

(B) A loss of eligibility in years 6 and 7 of the license term will result in a forfeiture of 75 percent of the value of the bidding credit (or in the case of eligibility changing to qualify for a lower bidding credit, 75 percent of the difference between the bidding credit received and the bidding credit for which it is eligible);

(C) A loss of eligibility in years 8 and 9 of the license term will result in a forfeiture of 50 percent of the value of the bidding credit (or in the case of eligibility changing to qualify for a lower bidding credit, 50 percent of the difference between the bidding credit received and the bidding credit for which it is eligible); and

(D) A loss of eligibility in year 10 of the license term will result in a forfeiture of 25 percent of the value of the bidding credit (or in the case of eligibility changing to qualify for a lower bidding credit, 25 percent of the difference between the bidding credit received and the bidding credit for which it is eligible).

(ii) For licenses initially granted before April 25, 2006, the amount of payments made pursuant to paragraph

(d)(1) of this section will be reduced over time as follows:

(A) A transfer in the first two years of the license term will result in a forfeiture of 100 percent of the value of the bidding credit (or in the case of very small businesses transferring to small businesses, 100 percent of the difference between the bidding credit received by the former and the bidding credit for which the latter is eligible);

(B) A transfer in year 3 of the license term will result in a forfeiture of 75 percent of the value of the bidding credit;

(C) A transfer in year 4 of the license term will result in a forfeiture of 50 percent of the value of the bidding credit;

(D) transfer in year 5 of the license term will result in a forfeiture of 25 percent of the value of the bidding credit; and

(E) For a transfer in year 6 or thereafter, there will be no payment.

(iii) These payments will have to be paid to the United States Treasury as a condition of approval of the assign-

ment, transfer, ownership change, or reportable eligibility event (see §1.2114).

* * * * *

3. Revise paragraph (a) of §1.2114 to read as follows:

§ 1.2114 Reporting of Eligibility Event.

(a) A designated entity must seek Commission approval for all reportable eligibility events. A reportable eligibility event is:

(1) Any spectrum lease (as defined in § 1.9003) or resale arrangement (including wholesale agreements) with one entity or on a cumulative basis that might cause a licensee to lose eligibility for installment payments, a set-aside license, or a bidding credit (or for a particular level of bidding credit) under § 1.2110 and applicable service-specific rules.

(2) Any other event that might lead to a change in the eligibility of a licensee for designated entity benefits.

* * * * *

STATEMENT OF CHAIRMAN KEVIN J. MARTIN

Re: Implementation of the Commercial Spectrum Enhancement Act and Modernization of the Commission's Competitive Bidding Rules and Procedures, Order on Reconsideration of the Second Report and Order (WT Docket No. 05-211), FCC 06-78

These changes to our designated entity rules arose out of a last-minute proposal in the proceeding to adopt rules for the Advanced Wireless Services spectrum. While I supported examining potential changes to our designated entity rules for future auctions, I did not believe the rules needed to be changed, especially in advance of the auction this summer. Nevertheless, I agreed to the changes in order to obtain the support needed to establish the rules for wireless services that were essential to making the spectrum available for wireless broadband services this summer.

STATEMENT OF COMMISSIONER MICHAEL J. COPPS

Re: Implementation of the Commercial Spectrum Enhancement Act and Modernization of the Commission's Competitive Bidding Rules and Procedures (Order on Reconsideration of the Second R&O, WT Docket No. 05-211).

Today's reconsideration order reaffirms that this Commission will not tolerate unjust enrichment or fraud in the Designated Entity (DE) program. In light of allegations that some of our prior auctions were tainted by such practices, I believe we have a clear duty to take affirmative action to eliminate loopholes in our existing rules.

I repeat here what I have stated previously—we should have begun our consideration of these rules last summer. That would have given us an opportunity to reach consensus on the important question of which companies should be allowed to acquire a partnership interest in a DE. Unfortunately, revisiting that question at this point would mean further postponing the long-scheduled AWS auction. That we cannot do.

Study after study demonstrates that our nation's broadband infrastructure lags dramatically behind other industrialized nations. In order to reverse this trend, we must encourage "third pipe" technologies to provide some at least some challenge to the cable/telco broadband duopoly in our cities. In rural areas, the situation is even graver. The GAO recently announced that the Commission has not even properly *measured* the rural-urban broadband gap—a gap that no one disputes is both significant and deeply troubling. In underserved

rural regions of our country, AWS spectrum can provide a desperately needed "first pipe." The upcoming auction can be an important step in making this happen.

STATEMENT OF COMMISSIONER JONATHAN S. ADELSTEIN APPROVING IN PART, CONCURRING IN PART

Re: Implementation of the Commercial Spectrum Enhancement Act and Modernization of the Commission's Competitive Bidding Rules and Procedures; Order on Reconsideration of the Second Report and Order; WT Docket No. 05-211

I support the specific clarifications in this Order on Reconsideration because they in part respond to legitimate concerns from designated entities regarding the possibly retroactive application of new rules. I have this lingering concern, though, that the Commission's course of action in this troubled proceeding, notwithstanding the legal maneuvering in this decision, may still leave other issues unresolved. As I have noted before, much of this uncertainty could have been avoided had we started this proceeding earlier and kept it more narrowly focused. I hope that the Commission's decisions over the past several months do not prove to be the undoing of our most significant auction in 10 years.

STATEMENT OF COMMISSIONER DEBORAH TAYLOR TATE APPROVING IN PART, CONCURRING IN PART

Re: Implementation of the Commercial Spectrum Enhancement Act and Modernization of the Commission's Competitive Bidding Rules and Procedures, Order on Reconsideration of the Second Report and Order (WT Docket No. 05-211)

Just last week, I was able to observe first-hand some of the most extraordinary applications of digital communications services in our country, from life-saving telemedicine in very remote villages, to the participation of a parent via satellite in a child's graduation hundreds of miles away. These experiences that we in the lower 48 states take for granted are major feats of coordination in Alaska. I also heard from many of those whose participation in the designated entity ("DE") program is critical to those same remote citizens. I am sympathetic to the concerns of DEs, who argue that requiring repayment of license discounts prior to the end of a ten year "hold period" will discourage investment and potentially limit a significant portion of designated entity participation in future spectrum auctions.

However, as always, our decision involves a balancing of interests. I therefore concur in this decision knowing that our efforts were to strengthen, not weaken, the purposes of the DE program to ensure against the potential for fraud, waste, and abuse, as well as to provide adequate notice in order that the AWS auction can occur in a timely and fair manner.

APPENDIX C

FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

WT Docket No. 05-211

IN THE MATTER OF
IMPLEMENTATION OF THE COMMERCIAL SPECTRUM ENHANCEMENT ACT AND MODERNIZATION OF THE COMMISSION'S COMPETITIVE BIDDING RULES AND PROCEDURES

Adopted: Mar. 24, 2008
Released: Mar. 26, 2008

SECOND ORDER ON RECONSIDERATION OF THE SECOND REPORT AND ORDER

By the Commission:

1. In this Second Order on Reconsideration, we formally deny a Petition for Expedited Reconsideration ("Petition") filed in this proceeding by Council Tree Communications, Inc., Bethel Native Corporation, and the Minority Media and Telecommunications Council (collectively, the "Joint Petitioners").[1]

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[1] Petition for Expedited Reconsideration, filed by Council Tree Communications, Inc., Bethel Native Corporation, and the Minority Media and Telecommunications Council, dated May 5, 2006 (the "Petition").

2. The Petition sought reconsideration of various decisions we made in the *Second Report and Order* released on April 25, 2006, which modified our Part 1 competitive bidding rules governing designated entities, including rules on eligibility for benefits and unjust enrichment.[2] The *Second Report and Order* was published in the Federal Register on May 4, 2006.[3] Joint Petitioners filed their Petition on May 5, 2006. On June 2, 2006, prior to the deadline for filing petitions for reconsideration of the *Second Report and Order*,[4] we released, *sua sponte*, an *Order on Reconsideration*, which considered and rejected the arguments included in the Petition without formally denying the Petition.[5] The *Order on*

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[2] Implementation of the Commercial Spectrum Enhancement Act and Modernization of the Commission's Competitive Bidding Rules and Procedures, *Second Report and Order and Second Further Notice of Proposed Rule Making*, 21 FCC Rcd 4753 (2006) ("*Second Report and Order*") "Designated entities" are small businesses, businesses owned by members of minority groups and/or women, and rural telephone companies *See* 47 C.F.R. § 1.2110(a). Unless otherwise noted, when referring to "designated entities," we include as a subgroup "entrepreneurs" eligible to bid for "set-aside" broadband Personal Communications Service licenses offered in closed bidding. *See id.* §§ 1.2110(a), 24.709.

[3] 71 Fed. Reg 26,245 (May 4, 2006).

[4] *See* 47 C.F R. §§ 1.4, 1.429.

[5] Implementation of the Commercial Spectrum Enhancement Act and Modernization of the Commission's Competitive Bidding Rules and Procedures, *Order on Reconsideration of the Second Report and Order*, 21 FCC Rcd 6703 (2006) ("*Order on Reconsideration*"). Subsequent to adoption of the *Order on Reconsideration*, we received two additional timely petitions for reconsideration of the *Second Report and Order*. *See* Petition for Partial Reconsideration and/or Clarification, filed by the Blooston Rural Carriers, dated June 2, 2006; Petition for Reconsideration and Clarification, filed by Cook Inlet Region, Inc , dated June 5, 2006.

Reconsideration was published in the Federal Register on June 14, 2006.[6]

3. In a July 2006 letter to the Commission, Joint Petitioners stated that the Commission had already decided the merits of the Petition and that the Joint Petitioners were no longer seeking reconsideration.[7] Accordingly, they ask that we formally dispose of their Petition in order to take "the *de jure* action" we had already "taken *de facto*."[8] We agree with Joint Petitioners that we already decided the merits of the Petition in the *Order on Reconsideration*. As Joint Petitioners have stated, the *Order on Reconsideration* "was . . . a conclusive rejection of Petitioners' legal arguments,"[9] and, as such, we need go no further here.

4. Accordingly, IT IS ORDERED that pursuant to Sections 4(i), 5(b), 5(c)(1), 303(r), and 309(j) of the Communications Act, as amended, 47 U.S.C. §§ 154(i), 155(b), 155(c)(1), 303(r), and 309(j), the Petition is hereby DENIED.

FEDERAL COMMUNICATIONS COMMISSION

Marlene H. Dortch
Secretary

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[6] 71 Fed. Reg. 34,272 (June 14, 2006).

[7] Letter, filed by Dennis P. Corbett and S Jennell Trigg, Counsel for the Joint Petitioners, to Marlene H. Dortch, Secretary, Federal Communications Commission, dated July 24, 2006.

[8] *Id* at 2.

[9] Petition for Writ of Mandamus, *In re Council Tree Communications, et al.*, 07-4124, at 20 (3d Cir. filed Oct. 23, 2007).

Supreme Court, U.S.
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No. 10-834

IN THE
Supreme Court of the United States

COUNCIL TREE INVESTORS, INC., BETHEL NATIVE CORPORATION, AND THE MINORITY MEDIA AND TELECOMMUNICATIONS COUNCIL,

Petitioners,

v.

FEDERAL COMMUNICATIONS COMMISSION AND THE UNITED STATES OF AMERICA,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

REPLY BRIEF FOR THE PETITIONERS

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March 8, 2011

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CORPORATE DISCLOSURE STATEMENT

The corporate disclosure statement included in the Petition for a Writ of Certiorari in this case remains accurate.

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REPLY BRIEF FOR THE PETITIONERS

The petition and supporting amicus briefs demonstrate a longstanding conflict in the lower courts over whether Congress meant what it said when it provided in Section 706 of the APA that a reviewing court "shall . . . hold unlawful and set aside agency action" not in accordance with law or required procedures, 5 U.S.C. § 706. *See* Pet. 16-23. That question has deep, historic roots and is the subject of an ongoing, animated debate among the courts of appeals, within the D.C. Circuit, and in the academic literature. *Id.*, *see also* Rodriguez Br. 5-12. The Government does not deny that the proper construction of Section 706 is a recurring question of enduring importance in the administration of hundreds of federal regulatory regimes. *See* S.Ct. R. 10(c). The Government instead resists certiorari on narrow grounds, attempting to show that this case is not a proper vehicle for resolving undeniably important questions regarding the scope of courts' remedial authority under the APA. Because those objections are baseless, the petition should be granted.

I. The Decision In This Case Contributes To A Longstanding Circuit Conflict.

The Government makes little effort, and even less headway, in attempting to deny the widely recognized division and confusion among the courts of appeals over whether courts have discretion under Section 706 to decline to set aside unlawful agency action. *See* BIO 14 n.12. It argues instead that the conflict is not implicated by this case. BIO 14 & n.12. The Government is wrong. The split is real

and squarely presented for this Court's resolution in this case.

The Government does not deny the petition's showing that prior to the 1990s, courts (including this Court) accepted as a matter of course that an unlawful agency action must be vacated. *See* Pet. 16-17 & n.15. The Government further acknowledges that recently, some circuits have changed course and declined to give force to the mandatory language of Section 706. BIO 14 n.12. Even more, the Government concedes that the Tenth Circuit categorically rejected that trend in *Forest Guardians v. Babbitt*, 174 F.3d 1178 (10th Cir. 1999). *See* BIO 14 n.12.

The Government nonetheless denies there is a circuit conflict. While not disputing the plain holding of *Forest Guardians*, it contends that the Tenth Circuit limits its recognition of the mandatory requirements of Section 706 to cases under Section 706*(1)*, and applies the exact opposite rule under Section 706*(2)*. *Id.* This would be exceedingly strange, if it were true. The operative language – the word "shall" – applies equally to both subsections. *See* 5 U.S.C. § 706. The Government is thus reduced to arguing that the Tenth Circuit reads "shall" to mean "shall" with respect to subsection (1) and "may" with respect to subsection (2).

Unsurprisingly, the Government's authority does not support its assertion. To start, nothing in the analysis in *Forest Guardians* turned on anything in the statute specific to subsection (1). Quite to the contrary, the entire basis of that decision was the court's simple, but unassailable, conclusion that

"when a statute uses the word 'shall,' Congress has imposed a mandatory duty upon the subject of the command." 174 F.3d at 1187. The Government relies instead on *Qwest Corp. v. FCC*, 258 F.3d 1191 (10th Cir. 2001), which, it implies, cabined the rule of *Forest Guardians* to Section 706(1) cases. BIO 14 n.12. To the contrary, *Qwest* cited *Forest Guardians* not to distinguish it, but for the proposition that the word "shall" in a statute "indicates a mandatory duty." 258 F.3d at 1200. Moreover, having found an FCC order unsupported, the court held that it "therefore *must* reverse the order and remand for further proceedings." *Id.* at 1205 (emphasis added).

Unable to support its reading of Tenth Circuit precedent on the basis of that court's precedential opinions, the Government cites instead a single unpublished (and, indeed, publically unavailable) order issued after the decision in *Qwest*. BIO 14 n.12. But an unpublished order cannot establish the law of the Tenth Circuit, or undermine the clear authority of prior published precedent. *See* 10th Cir. R. 32.1(A).[1]

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[1] Even if the order were relevant authority, it would indicate, at most, that the Tenth Circuit would allow an agency a chance to further explain the basis of its rules before conclusively determining that a rule was unlawful and, therefore, subject to the mandatory remedy of Section 706. *See* Pet. 19 n.16. *Compare Nat'l Org. of Veterans' Advocates, Inc. v. Sec'y of Veterans Affairs*, 260 F.3d 1365, 1380 (Fed. Cir. 2001) (allowing an agency a second chance to better explain its action), *with PGBA, LLC v. United States*, 389 F.3d 1219, 1225-26 (Fed. Cir. 2004) (construing Section 706 as mandating vacatur of unlawful agency action).

II. This Case Fairly Presents The Question Upon Which The Courts Of Appeals Are Divided.

The Government argues next that the Third Circuit's refusal to set aside the auction results in this case does not implicate the circuit conflict. BIO 15. But that claim is unpersuasive as well.

The Government contends that the Third Circuit expressly declined to engage the circuit conflict over the scope of remedial discretion under Section 706, because "it found remand without vacatur inappropriate" in this case with respect to the *rules*. BIO 14. But the Government ignores that the same remedial question necessarily arose with respect to the unlawfully conducted *auctions*. *See* Pet. App. 47a-50a (deciding separately whether to vacate rules and whether to vacate auction results). And it does not contest that the Third Circuit treated *that* remedial question as a matter of discretion. *See* BIO 15. The decision not to vacate the auction results was in line with prior Third Circuit precedent, which has remanded rules without vacating them, consistent with the "remand without vacatur" precedent of the D.C. Circuit. *See Prometheus Radio Project v. FCC*, 373 F.3d 372, 411-12 (3d Cir. 2004) (remanding without vacating Commission rule issued, to petitioner's prejudice, without notice of underlying methodology).

The Government nonetheless fails to acknowledge that the Third Circuit was merely following its own precedent in this case, and contends instead that petitioners failed to argue that Section 706 precluded equitable discretion as applied to the auction results. BIO 15. Not so. The

Government acknowledges that petitioners argued in no uncertain terms that the mandatory language of Section 706 left no room for remedial discretion with respect to the rules. BIO 14. There was no need to repeat that argument in the same level of detail with respect to the auctions – the proposition that the same language of the same provision means the same thing in both contexts goes without saying. In any event, petitioners repeatedly pressed the argument below that the auctions *and* the rules would *necessarily* stand or fall together. Petitioners argued, for example, that the rules were "inextricably intertwined with actual auctions" and that it was "logically impossible to separate the New DE Rules from the auctions that were conducted on the basis of those rules." Pet'rs. Supp. Br. 32-33. Because the "rules and auctions themselves are 'joined at the hip,'" petitioners insisted that "[i]f the basic auction rules fall, so *must the auction results produced by those rules.*" *Id.* (emphasis added) (footnote omitted).[2]

To be sure, as the court of appeals noted, petitioners also argued in the alternative that the court should exercise any remedial discretion it had in favor of vacating the auction results. Pet. App. 47a. But the Third Circuit's opinion did not conclude that petitioners took the unsupportable and illogical position that identical language of Section 706 was mandatory as applied to the rules and discretionary as applied to the auction results.

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[2] *See also* Pet'rs. Br. 5, 19, 49.

III. The Government's Alternative Grounds For Affirmance Are Unavailing.

The Government further argues that certiorari is unwarranted because petitioners' claims "fail on the merits." BIO 16. Tellingly, the Government makes no attempt to defend the proposition that Section 706 afforded the Third Circuit discretion to refuse to set aside unlawful agency action. Nor could it. In the similar context of *FCC v. NextWave Pers. Comm'ns Inc.*, this Court affirmed the D.C. Circuit's decision setting aside the FCC's revocation of NextWave's spectrum licenses in violation of federal bankruptcy law. 537 U.S. 293, 307-08 (2003). This Court explained that the APA "*requires* federal courts to *set aside* federal agency action that is 'not in accordance with law,' 5 U.S.C. § 706(2)(A)." *Id.* at 300 (emphasis added). Just as the APA required setting aside the FCC's unlawful revocation of licenses in *NextWave*, it demands vacatur of the FCC's unlawful conduct of auctions in this case.

The Government presents two alternative grounds for affirmance, neither of which was passed upon below or provides a reason to abstain from resolving the circuit conflict presented by the Third Circuit's actual decision.

First, the Government argues that petitioners did not "timely challenge any order regarding the AWS or 700 MHz auctions." BIO 16. The Government admits petitioners timely challenged the order establishing the offending DE rules, *id.*, but asserts that petitioners were also required to challenge some other agency order to establish jurisdiction over the auction results. *Id.* The

Government cites no case establishing that proposition, nor does it even say clearly which order it believes petitioners should have challenged. *Id.* & n.14. It seems, however, to concede that it would be sufficient to have challenged an "order regarding the AWS or 700 MHz auctions," *id.* at 16, including an order reflecting the "decision to apply the DE rules in the [relevant] auction," FCC Br. 16, D.C. Circuit Case No. 07-1454.

Petitioners did just that, challenging the *Second R&O*, which had not only modified the DE rules, but expressly applied those modifications *to impending Auction 66 and all future auctions*. *See* BIO App. 6a ("These rules *will be applied* to *any application* filed to participate in *auctions* in which bidding begins after the effective date of the rules adopted herein . . . .) (emphasis added); *see also First Reconsideration Order*, BIO App. 107a-112a (reviewing at length, and rejecting, arguments that the new rules should not apply to the then imminent Auction 66). The *Second R&O* thus is plainly not only an "order regarding the . . . auction," BIO 16, within the meaning of the APA's review provisions, but the order which most directly harmed petitioners, making it the most appropriate vehicle for challenging the unlawful agency action in this case.[3]

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[3] The Government's criticism of petitioners for an alleged failure to challenge in the D.C. Circuit the issuance of particularized licenses to auction winners is misplaced. BIO 17 n.15, *citing* 47 U.S.C. § 402(b)(6). *Freeman Eng'g Assocs., Inc. v. FCC* held that although the FCC's grant of a pioneer's preference "effectively . . guarantees [the grantee] a license," that grant is not an award of a license within the meaning of

Second, the Government argues that the Third Circuit had no authority to set aside the auction results because "that court nowhere found that the Commission's decision to hold the auctions under its revised DE rules violated any provision of the APA." BIO 17. That assertion is specious. Had the Third Circuit concluded that the auctions themselves were lawful, it would not have undertaken to decide whether it should exercise discretion to set the auction results aside. Nor was there any ground for the court to doubt that it was unlawful for the Commission to conduct an auction in accordance with unlawful rules. Congress required the Commission to conduct spectrum auctions in accordance with rules that promote DE participation, and the APA required that those rules be issued through certain procedures. The Commission's failure to comply with those requirements meant that the auctions themselves were conducted "without observance of procedures required by law," 5 U.S.C. § 706(2)(D), and therefore were subject to remedy under Section 706.

Of course, as petitioners have acknowledged, the mandatory remedy under Section 706 is tempered by

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47 U S C. § 402(b)(6) because it "does not irrevocably commit the Commission to grant a license." 103 F.3d 169, 174, 177 (D.C Cir. 1997). The grantee must still apply and qualify for an actual license. Petitioners here challenge auctions which also do not "irrevocably commit" the FCC to grant a license. Rather, auction winners obtain the right to later file particularized license applications, which are then subject to public notice and petitions to deny. *See* Public Notice, *Auction of Advanced Wireless Services Licenses Closes*, 21 F.C.C.R. 10521, 10526-27 (2006).

the provision's recognition of the "rule of prejudicial error." *See* Pet. 28 (quoting 5 U.S.C. § 706). But the Government has never claimed that applying the unlawful DE rules to these auctions was non-prejudicial. Nor could it. Although the Government now attempts to minimize the damage done to Congress's policy of promoting small business participation in the telecommunications market and preventing concentration of power in that industry, the effects of the illegal rules on the auction results were significant by any measure,[4] and so detrimental to small businesses' success in the auctions that even the FCC's sister agency, the Office of Advocacy, U.S. Small Business Administration, objected to their continued use. Pet. 10.

IV. The Court Of Appeals Improperly Failed To Provide Any Remedy At All For Petitioners' Effective Exclusion From The Unlawfully Conducted Auctions.

Finally, the Government's tepid defense of the Third Circuit's refusal to provide petitioners any remedy at all is entirely unconvincing. The

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[4] The Government attempts to obscure the damage by focusing on the absolute number of DEs participating in the auction and winning at least some spectrum. BIO 9. But these statistics include many incumbent DEs that were able to purchase low-value licenses in thinly populated rural areas that were of no interest to the dominant carriers. *See* Antares Holding, LLC et al Br. 11-12 n.9. They do nothing to obscure the harm done to Congress's policy of preventing consolidation of the telecommunications industry in major markets. *Id.* Nor do they say anything about the harmful effects of the unlawful actions on the particular parties to this action. *See* Pet. 5-6, 8-9

Government does not dispute that even if the APA affords some remedial discretion, it does not go so far as to permit a court to deny an injured party all relief when some remedy short of setting aside the agency action is reasonably available. It argues instead that petitioners were, in fact, given a remedy because the Third Circuit prospectively precluded the Commission from using the unlawful rules in future auctions. BIO 20-21.

That argument ignores that petitioners demonstrated two independent violations with distinct harms. The first was the promulgation of the unlawful rules, which the Third Circuit remedied by setting those rules aside. The second violation occurred when the agency applied those rules to the particular auctions. As petitioners and supporting amici (Antares Holding, LLC et al.) have made clear, vacatur of the offending rules provided no relief for the specific injuries to those shut out from participating in these particular auctions.[5] No court would accept, for example, that an order prohibiting an employer from engaging in future racial discrimination would remedy (let alone "set aside") a prior discriminatory hiring decision. *Albemarle Paper Co. v. Moody*, 422 U.S. 405, 418 (1975) ("Where racial discrimination is concerned, 'the

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[5] The Government cannot seriously claim that the injury from conduct of the auctions to Council Tree – much less to petitioner Bethel Native Corporation and the members of petitioner Minority Media and Telecommunications Council – was remedied by the circumstance that another company, owned in small minority part by several Council Tree principals, received some limited benefit from rule vacatur. *See* BIO 21; *Cf.* Pet. 9 n.10.

(district) court has not merely the power but the duty to render a decree which will so far as possible eliminate the discriminatory effects of the past as well as bar like discrimination in the future'").

As the amicus brief of John Muleta, former Chief of the FCC's Wireless Telecommunications Bureau, demonstrates, the Commission could have provided (and can still provide) alternative remedies that would not have had the disruptive effects the FCC claims would make a reauction impractical. *See* Muleta Br. 11-15. The Government's brief raises no objections to any of those options. In fact, the Commission itself suggested to the Third Circuit that alternative remedies could be explored by the agency in a remedial remand, pointing to the D.C. Circuit's practice of such remands in similar cases. Respts. Supp. Br. 33-34. Nor have any of the private intervenors in this case come forward in this Court for any purpose, much less to defend the complete denial of relief to petitioners or to suggest that it would be unfair or impractical to provide petitioners an alternative remedy.[6]

In such circumstances, this Court should, at the very least, summarily vacate the decision with

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[6] The Government suggests that no remedy is due because petitioners committed a "jurisdictional misstep" that, the Government asserts, delayed final resolution of this case. BIO 7, 19. In fact, the FCC's own jurisdictional gamesmanship caused concurrent, and ultimately lengthier delay. *See* Pet. App. 11 n.14 (recognizing that the FCC's refusal to rule on petitioners' long pending reconsideration request was preventing adjudication of their challenges to the DE rule changes).

respect to the auction results and require the Third Circuit to remand the case to the agency to consider alternative remedies, consistent with the FCC's own advice and the established practice of the D.C. Circuit. Pet. 30-31.

* * * *

In the end, review is particularly merited in this case because the underlying agency violation of law was serious and stark, leading both to "blind" regulation without the notice and opportunity to comment demanded by the APA, and to auctions that devastated the interests of statutorily favored stakeholders (DEs) and the public, to the benefit of a very few large, dominant companies, all in derogation of clearly articulated Congressional objectives favoring competition and diversity.

CONCLUSION

For the foregoing reasons, and those set forth in the petition, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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IN THE

Supreme Court of the United States

COUNCIL TREE INVESTORS, INC., BETHEL NATIVE CORPORATION, AND THE MINORITY MEDIA AND TELECOMMUNICATIONS COUNCIL,

Petitioners,

v.

FEDERAL COMMUNICATIONS COMMISSION AND THE UNITED STATES OF AMERICA,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

BRIEF OF *AMICI CURIAE* ANTARES HOLDING, LLC, *ET AL.* IN SUPPORT OF PETITIONERS

(Additional *Amici* Listed on Inside Cover)

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COMPLETE *AMICI CURIAE*

Antares Holding, LLC
Business Intelligence Solutions
Brian O'Reilly
Dempster Group, LLC
Faithfone Wireless, Inc.
Gilbert H. Scott, Sr.
Kinex Networking Solutions, Inc.
Rocking "R" International, Inc.

Asian American Justice Center ("AAJC"), a member of the Asian American Center for Advancing Justice
Benton Foundation
Media Access Project
Media Alliance
National Association for the Advancement of Colored People ("NAACP")
National Association of Multicultural Digital Entrepreneurs
National Hispanic Media Coalition ("NHMC")
National Indian Telecommunications Institute ("NITI")
National Organization for Women Foundation ("NOW Foundation")
National Urban League
Office of Communication of the United Church of Christ, Inc. ("UCC")
Public Knowledge
Rainbow PUSH Coalition
Women's Institute for Freedom of the Press ("WIFP").

QUESTION PRESENTED

Whether a reviewing court has the discretion under Section 706 of the Administrative Procedure Act ("APA") to decline to set aside, or provide any remedy for, unlawful agency action?

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INTEREST OF *AMICI CURIAE*

Amici consist of two groups[1] both of whose interests are set forth herein and have been directly and adversely impacted by the Federal Communications Commission's (the "FCC" or the "Commission") unlawful implementation of final rules that dramatically altered the rules governing designated entities ("DEs"). The New DE Rules were implemented immediately prior to the largest electromagnetic spectrum auctions in the history of the United States to the substantial detriment of the *Amici*. The Third Circuit recognized and acknowledged this detriment yet failed to appropriate an adequate remedy to make whole DEs that relied on the DE rules to effectively compete and participate in those auctions.

The first group of *Amici* is comprised of DEs who desire to participate in spectrum auctions as Congress intended as vital players contributing to wireless competition and the dissemination of licenses to a wide variety of applicants, as well as an individual with experience advising DEs on financing matters ("DE *Amici*"). This group was denied the opportunity to bid at the spectrum auctions that were

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[1] Pursuant to Supreme Court Rule 37.2(a), *Amici* represent that counsel of record for all parties received timely notice of the intent to file this brief and all parties have provided written consent. A letter from the Petitioners reflecting their global consent to the filing of *amicus curiae* briefs is on file with the Clerk of the Court. No counsel for any party has authored any portion of this brief, nor has any person or entity, other than *amici* and their counsel, made a monetary contribution to the preparation or submission of this brief.

devastated by the last-minute rule changes and has not been provided any other form of redress or remedy despite the Third Circuit's agreement that DEs were indeed harmed by the rule changes.

The second group of *Amici* includes civil rights, public interest, and minority and women's groups ("Public Interest *Amici*"), that support the use of public airwaves in a manner that encourages participation from diverse groups traditionally locked out from owning a share of wireless spectrum, a public asset. Many among the Public Interest *Amici* represent the interests of the underserved minority communities on which DEs often focus because of the challenges of penetrating the wireless market that is dominated by a few brands. Therefore, it is in the interest of Public Interest *Amici* that their constituencies and members are not negatively impacted by decisions that foreclose opportunities to DEs and limit their options to benefit from a vibrant and competitive wireless market.

Both the DE and Public Interest *Amici* encourage invalidation of the tainted auctions conducted under the unlawful New DE Rules. In addition, *Amici* expressly and respectfully request that the Court grant Petitioners' plea for certiorari.

The DE *Amici*:

Antares Holding, LLC, was unsuccessful in its participation in Auction 66 under the New DE Rules and decided to pass on participating in Auction 73 altogether. The owner of Antares had previously founded a successful DE, Northcoast Communications, LLC, which under the old DE rules

won approximately $230 million of PCS licenses in FCC Auctions 11 and 35. Northcoast subsequently built out its markets and operated a new wireless business in three Ohio markets (Cleveland, Youngstown, and Canton), providing wireless service to approximately 80,000 subscribers.

Business Intelligence Solutions is a minority and military veteran-owned management and technology consulting firm. Business Intelligence Solutions applied to participate in Auction 73 as a DE but ultimately did not bid because of the negative impact of the FCC's new DE restrictions on its business plan.

Brian O'Reilly is a private investor with extensive wireless industry experience, including a career as an investment banker advising and raising capital for some of the leading independent wireless carriers and DEs.

Dempster Group, LLC is an investment firm with a history of developing investment opportunities in small to mid-sized businesses, including those in the telecommunications sector. The Dempster Group applied to participate in Auction 66 as a DE but ultimately did not participate due to the impact of the new DE restrictions on this investment opportunity.

Faithfone Wireless, Inc. is a small business DE that filed an application to participate in Auction 73 with the objective of acquiring spectrum to deploy an innovative new service combining mobile telephony with faith and family content. Faithfone was not able to complete the application process for Auction 73.

Gilbert H. Scott, Sr. is the former Owner and CEO of OVTC Inc., a minority-owned small business DE that filed an application to participate in Auction 66, but did not ultimately qualify to bid in that auction due to difficulty obtaining financing.

Kinex Networking Solutions, Inc. is a small business DE that provides wireless and telecom services to business and residential customers. Kinex qualified as a bidder in Auction 73, but was unsuccessful in obtaining any licenses.

Rocking "R" International, Inc. is a subcontractor for the installation of satellite broadcasting and data systems serving rural areas of the Eastern United States. Rocking "R" International applied to participate in Auction 66 as a DE but did not ultimately bid in that auction due to difficulty raising capital because of the FCC's new DE restrictions.

The Public Interest *Amici* include:

Asian American Justice Center ("AAJC"), a member of the Asian American Center for Advancing Justice, is a national nonprofit, nonpartisan organization whose goal is to advance the civil and human rights of Asian Americans. It works in conjunction with its affiliates to provide legal public policy, advocacy, and community education on issues of discrimination that affect its constituents.

The Benton Foundation's mission is to articulate a public interest vision for the digital age and to demonstrate the value of communications for solving social problems. Established in 1981, it is concerned with the use of communications media on democracy and the public interest.

Media Access Project is a 38 year-old non-profit public interest telecommunications law firm which represents the interests of civil rights, civil liberties, consumer, religious and other organizations seeking, inter alia, to promote diversity in media and telecommunications industry. MAP has actively participated in FCC proceedings relating to the design and implementation of spectrum auctions.

Media Alliance is a 32-year old media advocacy group that works for an accountable and accessible media system. Its mission is to promote excellence, ethics, diversity, and accountability in all aspects of the media in the interests of peace, justice, and social responsibility.

National Association for the Advancement of Colored People ("NAACP") is the country's oldest civil rights organization. Founded in 1909, its core mission is to promote equality of rights, eradicate caste and racial prejudice among citizens of the United States, and secure for African Americans and other minorities increased opportunities in society.

National Association of Multicultural Digital Entrepreneurs ("NAMDE") is a one-of-a-kind Washington, D.C.-based trade association which advocates for, unites and promotes the interests of diverse companies, organizations, individuals and entities within the technology and broadband market industries.

National Hispanic Media Coalition ("NHMC") is a media advocacy organization established in 1986. Its goals include advocacy for media and telecommunications policies that benefit the Latino

community and increase opportunities for American Latinos in all facets of the media industry.

National Indian Telecommunications Institute ("NITI") is founded and operated by Native Americans. NITI is dedicated to opening channels for American Indians, Native Hawaiians, and Alaskan Native communities to present their own literary, artistic and educational contents in the media.

The National Organization for Women Foundation ("NOW Foundation") is the advocacy, education and litigation arm of NOW, the nation's largest feminist activist organization, devoted to empowering women and furthering women's rights and opportunities.

The National Urban League is a historic civil rights organization dedicated to economic empowerment in order to elevate the standard of living in historically underserved urban communities. Founded in 1910 and headquartered in New York City, the National Urban League spearheads the efforts of its local affiliates through the development of programs, public policy research and advocacy. Today, there are more than 100 local affiliates in 36 states and the District of Columbia, providing direct services that impact and improve the lives of more than 2 million people nationwide.

The Office of Communication of the United Church of Christ, Inc. ("UCC") has been at the forefront of media access issues for more than 40 years. It works to assure a just and equitable media that gives meaningful voice to diverse peoples, cultures and ideas.

Public Knowledge is a Washington, D.C.-based public interest group working to defend citizens' rights in the emerging digital culture.

Rainbow PUSH Coalition ("Rainbow PUSH") is a progressive advocacy group that works to ensure workers, women and people of color have access to opportunities. It also pursues social justice, civil rights and political activism among its constituent groups.

Women's Institute for Freedom of the Press ("WIFP") was established in 1972 as a research, education and publishing organization. It seeks to increase the role of women in the media by expanding freedom of the press, to enable all of society to have equal opportunities to present their views and concerns through a democratic process.

SUMMARY OF THE ARGUMENT

This case raises important questions concerning the remedy required by Section 706 of the Administrative Procedure Act ("APA"), 5 U.S.C. § 706 when a court finds that a federal agency has acted unlawfully. The Third Circuit's decision adds to a deep and historic division of authority within the circuits.

The combination of the New DE 50% Rule[2] and the Ten-Year Hold Rule[3] has abruptly destabilized the very business model favored by DEs, and, consequently, strangled their access to sustaining capital necessary to compete for spectrum licenses.

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[2] 47 C.F.R. § 1.2110(b)(3)(IV)(A) (2006) (now vacated)

[3] *Id.* § 1.2111(d)(2)(i) (now vacated).

As a result, the wireless industry has moved farther down the path of consolidated ownership among a few large entities in a marketplace that now, for all intents and purposes, excludes diverse owners and participants. In fact, the FCC itself decided for the first time in 2010 against ruling that there is effective competition in the wireless industry, instead taking a neutral stance.[4] The New DE Rules run directly and unambiguously contrary to Congress's unmistakable intent that the FCC devise spectrum auctions in a way that encourages involvement of DEs, including small businesses. As determined by the Third Circuit Court of Appeals, the New DE Rules are contrary to law.

While DE and Public Interest *Amici* applaud the Third Circuit's decision to vacate the Commission's seriously flawed and hastily implemented 50% and Ten-Year Hold Rules, *Amici* are concerned about the failure of the court of appeals to provide relief to Petitioners. The FCC's own Advisory Committee on Diversity for Communications in the Digital Age ("FCC Diversity Advisory Committee") acknowledged the inequity in the FCC's decision and issued a resolution in 2009 urging the FCC to reverse the rule changes.[5] The vacation of the rules without

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[4] *Annual Services Report and Analysis of Competitive Market Conditions with Respect to Commercial Mobile Wireless*, Fourteenth Report, WT Docket No. 09-66, 2010 WL 2020768, at *117 (May 20, 2010) ("CMRS Report").

[5] Federal Communications Commission Advisory Committee on Diversity for Communications in the Digital Age, Resolution Regarding Designated Entity Investment Rules (September 22, 2009) *available at*

any remedy to Petitioners has effectively foreclosed the opportunity for diverse Americans such as those represented by *Amici* – small businesses, and minority and women-owned businesses – from participating in the spectrum auctions and owning spectrum licenses, rendering Section 309(j) meaningless. *Amici*, therefore, respectfully request that this Court grant certiorari to review the Third Circuit's refusal to grant Petitioners any form of relief to remedy the Commission's unlawful actions

ARGUMENT

I. Introduction.

1. The United States Congress has made it explicitly clear that valuable communications spectrum licenses should be owned by a variety of Americans. Specifically, Section 309(j) of the Communications Act of 1934, as amended, commands the FCC, when awarding spectrum licenses through competitive bidding, to

> promot[e] economic opportunity and competition and ensur[e] that new and innovative technologies are readily accessible to the American people by avoiding excessive concentration of licenses and by disseminating licenses

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www.fcc.gov/DIVERSITYFAC/recommendations.html. ("FCC Diversity Advisory Committee Resolution") (The FCC Diversity Advisory Committee was created to make recommendations to the FCC regarding policies and practices that will further enhance the ability of minorities and women to participate in telecommunications and related industries.).

> among a wide variety of applicants, including small businesses, rural telephone companies, and businesses owned by members of minority groups and women.[6]

2. In response to this 1993 Congressional directive, the FCC has, over the years, implemented rules and initiatives to promote robust participation in spectrum auctions by small businesses, rural telephone companies, and minority and women-owned businesses, known collectively as designated entities, or DEs. These adopted initiatives reflect the Commission's recognition that, "although auctions have many beneficial aspects, *they threaten to erect another barrier to participation by small businesses and businesses owned by minorities and women by raising the cost of entry into spectrum-based services.*"[7] Notwithstanding this acknowledgment, the FCC has, over time, dismantled many of the various initiatives it has put in place to ensure diversity among owners of communications properties and spectrum, leaving in place today only bidding credits that reduce the amount qualified DE small businesses pay for spectrum won at auction.

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[6] 47 U.S.C. § 309(j)(3)(B)

[7] *Implementation of Section 309(j) of the Communications Act- Competitive Bidding*, Fifth Report and Order, 9 F.C.C.R. 5532, 5537,(¶10)(1994)("Fifth R&O")(Emphasis added) The Commission also recognized that it must "take the steps that are *necessary to ensure that designated entities have a realistic opportunity* to obtain [spectrum] licenses." *Id.*,(¶9)(emphasis added)

In 2006, merely weeks before one of the largest, most important auctions of public spectrum in history was scheduled to begin, the FCC effectively dismantled this last element of the DE Program without Congressional approval, advance notice, or appropriate deliberation. It did so by abruptly making several changes in its New DE Rules that were manifestly inimical to the interests of DEs.

3. The devastating effects of the New DE Rules were apparent immediately in Auction 66, the very first auction after their adoption by the FCC. Minority and women-owned telecommunications businesses that qualify as DEs are woefully underrepresented in the telecommunications industry.[8] However, instead of making it easier for these groups to compete and be represented as mandated by Congress, the New DE rules did the exact opposite. DEs found themselves unable to retain or arrange financing to bid on Auction 66 licenses that would allow them to compete with entrenched, incumbent providers.[9] Accordingly, with

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[8] Supplemental Joint Appendix ("SJA") to the Third Circuit, 409–11, 557 (No. 08-2036).

[9] Certain DEs (rural telephone companies) were ultimately able to obtain small slices of spectrum to cover their existing geographic service areas Largely shut out were those DEs that sought to pursue a different business model, provision of new services in non-rural, urban markets on a local, regional or nationwide basis to compete with the major incumbent wireless carriers. For this reason, FCC references to the total number of licenses obtained by DEs in auctions since adoption of the New DE Rules obscure the abysmal performance by DEs, including minority and women-owned DEs, who seek to provide new competition to incumbents in areas of high demand. *Compare Statement by FCC Chairman Kevin J. Martin*, FCC

DE participants hobbled, the large incumbents were enabled to consolidate their hold on spectrum and the wireless industry.[10] The damage from the auction only deepened with the very next major auction, Auction 73.[11] Under the New DE Rules, that auction also resulted in huge blocks of valuable and important spectrum, considered the most premium licenses, essentially being sold off carte blanche to the large incumbent wireless carriers.

4. Indeed, DE participation in spectrum auctions, measured by net value of licenses won, plummeted from an average of more than 70% in six major commercial mobile radio service auctions from 1996 to 2005, to 4.0% in Auction 66 and 2.6% in

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News Release (Mar. 20, 2008) (lauding the success of "small businesses" in Auction 73) *with Commissioner Jonathan S. Adelstein Comments on Lack of Diversity Among Winners of the 700 MHz Auction*, FCC News Release (Mar. 20, 2008) ("*Adelstein Release*") (decrying that minority- and women-owned bidders *together* won less than one percent of Auction 73 licenses).

[10] *See* Petitioners' Reply Brief to the Third Circuit 16-21 (No. 06-2943); *see also FCC Spectrum Auction Ends on $13.7 Billion High Note*, RCR Wireless News, Sept. 18, 2006, *available at* http://www rernews.com/apps/pbcs.d11/article?AID=/20060918/SUB.

[11] *See, e.g., Verizon and AT&T Dominate Airwaves Auction*, Reuters Business News, Mar 20, 2008, *available at* http //www reuters com/article/ technologyNews/idUSN2042023420080321?feedType=RSS&feedName=technologyNews (stating that Verizon and AT&T "grabbed the lion's share" of the 700 MHz licenses) (last visited Aug. 13, 2008).

Auction 73.[12] Reviewing the abysmal results of Auction 73, Commissioner Adelstein noted that "women-owned bidders failed to win any licenses and minority-owned bidders won less than one percent of licenses (7 of 1,090 licenses, or .64%)."[13] This result is inexcusable considering "that women constitute over half the U.S. population and minorities around one-third of the U.S. population."[14] Commissioner Adelstein lamented that:

> It's appalling that women and minorities were virtually shut out of this monumental auction. It's an outrage that we've failed to counter the legacy of discrimination that has kept women and minorities from owning their fair share of the spectrum. Here we had an enormous opportunity to open the airwaves to a new generation that reflects the diversity of America, and instead we just made a bad situation even worse.[15]

Commissioner Adelstein's concern has been echoed by the FCC which has continuously recognized that the

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[12] *See* Petitioners' Supplemental Appendix III to the Third Circuit, Tab 1, Exhibits B and E (No. 08-2036).

[13] *Adelstein Release, supra* note 9.

[14] *Id.; see also* SJA, *supra* note 8, at 461 ("auctions continue to disserve minority communities by excluding minority-owned businesses from owning needed licenses; wireless services in minority communications lag behind accordingly.").

[15] *Adelstein Release, supra* note 9.

wireless industry is in desperate need of competition. The FCC's Diversity Advisory Committee stated in its September 22, 2009 resolution that the FCC should consult with it before all auctions so that it could assist the agency to determine whether "overriding public policy goals or other factors warrant limiting the scope of closed licenses and whether such limitations should be balanced by an increase in bid credits."[16] Then, in the CMRS Report, the FCC decided against making a finding that there is effective competition in the wireless industry.[17] These pronouncements demonstrate that the FCC is on notice of the detrimental impact of its decisions. For the Court to not require the FCC to remedy this failure is a matter of great importance to the *Amici*.

II. A Remedy for the FCC's Unlawful Actions Must be Provided in Order To Fulfill Congressional Intent.

A. Fundamental Fairness, Rooted in the Rule of Law, Requires that a Litigant Who Has Demonstrated That An Agency Action Is Invalid Obtain Tangible Relief.

This Court in *Marbury v. Madison*, 5 U.S. 137, 163 (1803), established that if a right is violated, there must be a remedy:

> The very essence of civil liberty certainly consists in the right of every

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[16] *FCC Diversity Advisory Committee Resolution*, *supra* note 5.

[17] *See FCC dings wireless industry on competition*, Fierce Wireless, rel May 20, 2010 (http://www.fiercewireless.com/node/65539) (noting the FCC's summation in presenting the Order to the full Commission).

> individual to claim the protection of the laws, whenever one receives an injury...The government of the United States has been emphatically termed a government of laws, and not of men. It will certainly cease to deserve this high appellation, if the laws furnish no remedy for the violation of a vested legal right.

The Petitioners, as well as DE *Amici* who would have participated in the spectrum auction but for the unlawful New DE Rules, have been shut out of the spectrum ownership. There is uncertainty as to whether in instances as this case, where the harm is severe, a Court should appropriate some sort of remedy.

The lack of uniformity and consistency among the circuits in the formulation of judicial remedies frustrates the public's expectations of the APA's plain language as to the reviewing court's remedial authority over unlawful agency action.

At this time, the country cannot afford for the FCC to shut out competitors. On March 16, 2010, when the FCC released its National Broadband Plan, it acknowledged the transformative role that wireless technology has in society and economic progress.[18] It wrote:

> Spectrum policy must be a key pillar of U.S. economic policy. The contribution

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[18] Federal Communications Commission, *Connecting America: The National Broadband Plan* (rel. Mar 16, 2010) *available at* www.broadband.gov.

> of wireless services to overall gross domestic product grew over 16% annually from 1992–2007 compared with less than 3% annual growth for the remainder of the economy. Given these growth rates, wireless communications–and mobile broadband in particular–promises to be a significant contributor to U.S. economic growth in the coming decade.[19]

Three months later, in its CMRS report, the FCC staff noted that there has been a surge in usage of smartphones, pointing out that in 2004, 4 percent of consumer's monthly wireless bills related to wireless data charges; and that in 2008 that number rose to nearly 22 percent. Commissioner Copps expressed his concern over consolidation in the wireless market which has increased 32 percent since 2003, stating, "all of the findings in this report are not comforting."[20]

Without a remedy to ensure that DEs are able to be part of this growing market, there is a risk that the power and the public's assets in spectrum has become increasingly concentrated in the hands of a few. This possible outcome is of grave concern to *Amici* because several DEs have a tradition of serving underserved markets partly because the minority DEs, in particular, have a sense of connection to those communities. Also, because it is

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[19] *Id.* at p.75 (internal citations omitted).

[20] CMRS Report, Statement of Michael J. Copps, *supra* note 4, at *127.

difficult to compete against an incumbent who has brand loyalty, several DEs branch out and focus on some of the communities represented by the Public Interest *Amici*.

The FCC relegated DEs to the sidelines of spectrum auctions, boosting the concentration of entrenched incumbents large and small, while thwarting Congress' call for robust competition and diversity in spectrum auctions. This damage to Petitioners' was recognized by the Third Circuit, however no relief was provided.

B. The Third Circuit Misapplied Section 706 In Violation of the Administrative Procedure Act.

As the Petition for Writ aptly states, the Administrative Procedure Act does not permit the court of appeals to issue an order without appropriating a remedy. The misapplication of Section 706 warrants review in this case because of its detrimental effects on the nation's telecommunications policy. This particular unlawful agency action directly and substantially harmed small business and minority and women-owned business participation in two of the most important spectrum licensing auctions in the history of this country, encompassing vital nationwide, regional, and local licenses that govern the use of vast amounts of very valuable spectrum.[21] CA-JA 168.

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[21] Joint Appendix before the Third Circuit ("CA-JA")(No 08-2036). Commissioner Adelstein characterized Auction 66 as the agency's "most significant auction in 10 years," and referred to the spectrum made available in Auction 73 as "the finest crown jewels the FCC has to put up for auction." *Second Report and Order*, WT Docket No. 06-150, 22 F.C.C.R. 15289, 15564 (2009)

Further, if Section 706 is not applied, *Amici* and their members and constituents would suffer by having a smaller pool of wireless carrier providers from which to select.

Without some form of redress for the harms suffered when the FCC breached its obligation to provide notice and comment, *Amici* would be negatively impacted from the lack of effective competition and the dominance in the wireless industry of a few carriers. Moreover, the Public Interest *Amici* represent communities and members that would have benefitted from a wireless marketplace that included additional DEs, and in particular from those owned by women and minorities. Any action by a court that would further perpetuate acquisition of valuable spectrum by a limited pool of carriers is improper. Failure to provide some sort of remedy in cases such as this one goes against the spirit of Section 706 of the APA. 5 U.S.C. § 706; *Forrest Guardians v. Babbitt*, 74 F. 3d 1178, 1191 (10th Cir. 1999).

C. The Third Circuit's Failure to Grant a Remedy Chills Challenges to the Commission's Unlawful Activities.

The Third Circuit's refusal to disturb flawed administrative actions unlawfully and unduly reduces the public's incentive to challenge agency decisions. It may well also lessen governmental agencies' incentive to carefully craft their regulations in the first instance.

The consequences flowing from such discretionary judicial restraint raise serious public policy issues of concern to *Amici*. When a court

rules, but fails to assign a remedy to the petitioning party, that court is essentially stripping the APA of its effectiveness. This action would have the subsequent effect of diminishing the rights of the public. This is not to say a remedy is mandatory, explicitly for casual inconsequential matters, but for issues with grave consequences as in this case, absence of a remedy is almost unconscionable.

The present refusal to remedy the unlawful act also stands as a deterrent to challenges to even the most blatant agency violations. The decision could also have the chilling effect of deterring future challenges. Substantial time and resources are necessary to challenge an agency decision, but if the courts continue to provide only prospective relief from a rule which application had previously caused substantial harm without unwinding the resulting effects of unlawful actions, the public would be less inclined to speak up when it is harmed by any unlawful agency action. Prospective relief on an ongoing basis fails to adequately address the harm sustained by the unlawful agency action.

Not only are the DE *Amici* manifestly impacted by the divergence among the circuit courts as to the nature and scope of a proper remedy when violations under the APA are found, DE *Amici* also join the Public Interest *Amici* in their national policy concerns regarding the Third Circuit's decision to remand the voided regulation without imposing any additional meaningful remedy.

Another impact of a vacatur without a remedy is that it rewards agencies for their wrongdoing. Such an outcome would be outrageous especially in those cases where the agency purposefully delays

acting in hopes that the complaining party will get frustrated by the time and process and abandon its complaint, or in order to make it difficult for a court to reverse its decision due to the passage of time. Both scenarios are present in this proceeding. The Third Circuit decided against a remedy to reverse the auctions because several incumbents had won spectrum and significantly advanced their build-out of the spectrum won. Therefore, by not mandating a reversal or some other remedy, the court is *de facto* allowing bad action by an agency to stand without retribution.

D. Section 706 Should Have Been Applied in This Case Even if "Equitable Balancing" Is Available To The Court.

The court of appeals found that the Commission's actions in implementation of the New DE rules were seriously flawed. The court's use of "equitable balancing" failed to adhere to congressional intent of the promotion of diverse ownership of spectrum. It also failed to remedy the disparate impact of the unlawful regulations on small, minority and women-owned businesses.

The court of appeals focused on the potentially disruptive consequences of an interim change and held that because of that disruption, or perceived disruption, relief requested by the Petitioners would not be granted. Competing considerations do not appear to have been adequately addressed by the court of appeals. These considerations include the congressional intent to promote ownership of spectrum to a diverse variety of Americans as well as the promotion of

competition. Further, the court of appeals failed to consider the actual irreparable injury to petitioners as well as the DE *Amici*.

The Third Circuit also failed to consider the overall public interest in promoting the success of small and minority and women-owned businesses. These considerations clearly outweigh the potential disruptions on which the court focused. Moreover, the FCC's Diversity Committee warned in 2009 against the agency making a decision that would limit the scope of licensees without taking some other kind of action to counterbalance such limits.[22]

III. The Third Circuit Failed to Sanction the FCC for Its Improper Conduct.

Unless some remedy is imposed when an agency is found to have behaved unlawfully, that agency would be without incentive to adhere carefully to the procedural requirements of the APA, knowing that there is a possibility that if a court finds the agency's conduct unlawful, it will nonetheless decline to set the action aside.

As the New DE Rules were adopted, FCC Commissioner Adelstein accurately worried that the FCC's decisions in the "troubled proceeding" could eventually result in Auction 66 being overturned. *See* CA-JA 168.[23] Thus, in sum, the Commission, or at

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[22] *See FCC Diversity Advisory Committee Resolution, supra* note 5.

[23] *See also* CA-JA 166 (FCC Chairman Kevin Martin expounds his belief that the "last minute" changes were not "needed" but that he agreed to the same to "obtain the support necessary to ensure Auction 66 would be held in the summer of 2006.")

least one of its Commissioners, anticipated a type of remedy that the Court failed to administer. The precedent set by permitting an agency to go forward despite its improper conduct could be disruptive to public policy and goes against notions of equity and fairness.

CONCLUSION

For the reasons stated above, the DE *Amici* and Public Interest *Amici* respectfully ask that the Court grant the Petition for Writ of Certiorari.

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No. 10-834

IN THE
Supreme Court of the United States

COUNCIL TREE INVESTORS, INC., BETHEL NATIVE CORPORATION, AND THE MINORITY MEDIA AND TELECOMMUNICATIONS COUNCIL,

Petitioners,

v.

FEDERAL COMMUNICATIONS COMMISSION AND THE UNITED STATES OF AMERICA,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

BRIEF OF *AMICUS CURIAE* JOHN B. MULETA IN SUPPORT OF PETITIONERS

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QUESTION PRESENTED

Whether a reviewing court has the discretion under Section 706 of the Administrative Procedure Act, 5 U.S.C. § 706, to decline to set aside, or provide any remedy for, unlawful agency action?

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INTEREST OF *AMICUS CURIAE*[1]

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Mr. Muleta also served at the FCC from 1994 to 1998 as Deputy Chief of the Common Carrier Bureau (now known as the Wireline Bureau), Chief of the Enforcement Division of the Common Carrier Bureau and an attorney-advisor to the FCC's Office of Plans and Policies. Following his most recent service as chief of the Wireless Telecommunications Bureau, Mr. Muleta entered private practice as co-head of the Telecommunications Practice at Venable LLP. In

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[1] Pursuant to Supreme Court Rule 37.2(a), amicus represents that counsel of record for all parties received timely notice of the intent to file this brief and all parties have provided written consent. A letter from the Petitioners reflecting their global consent to the filing of *amicus curiae* briefs is on file with the Clerk of the Court. No counsel for any party has authored this brief in whole or in part, nor has any person or entity, other than amicus and his counsel, made a monetary contribution to the preparation or submission of this brief.

addition to his legal experience, Mr. Muleta has also had a distinguished career in the private sector having worked in various executive capacities at GTE Corporation, Coopers & Lybrand, PSINet Inc., Navisite, Inc. and M2Z Networks, Inc.

For 25 years, Mr. Muleta has been involved in nearly all facets of the telecommunications business and has extensive knowledge and background about the legal, regulatory, operational and financial implications of FCC spectrum auctions. This brief provides a perspective into how a meaningful remedy can and must be provided for the harm caused by the FCC's actions.[2]

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[2] Mr. Muleta wishes to acknowledge the valued assistance of John C. Fuller, Esquire, of Bryn Mawr, Pennsylvania, in the research and preparation of this brief.

INTRODUCTION AND SUMMARY OF THE ARGUMENT

This petition allows the Court to resolve the issue of whether lower courts have the discretion under Section 706 of the Administrative Procedure Act, 5 U.S.C. § 706, to decline mandating a judicial remedy after finding an agency has acted unlawfully. In this case, the United States Court of Appeals for the Third Circuit held that the FCC conducted two important spectrum licensing auctions (Auctions 66 and 73) pursuant to unlawful rules that significantly frustrated the ability of small businesses to meaningfully participate. Despite having set aside the offending rules as unlawfully promulgated and remanding the case to the FCC, the Third Circuit failed to mandate that the agency craft any remedy thereby giving rise to petition supported herein.

Petitioners have made a very strong argument on the express language of Section 706, but the focus of this brief is on the need, under any circumstances, for an effective remedy for unlawful agency action. This brief supports the Petitioners by challenging the reasonableness of the Third Circuit's assertion that mandating the FCC to provide a remedy would be "imprudent and unfair." *Council Tree Comm'ns v. FCC*, 619 F.3d 235, 257 (3d Cir. 2010). If universally applied, the Third Circuit's refusal to call for a remedy would effectively nullify the rights of aggrieved parties that seek judicial protection from unlawful agency actions. Such a result is untenable because it denies petitioners the very thing they seek in coming to the courts. It is also misguided because

the Third Circuit's decision to avoid mandating a remedy is based on policy arguments about the potential disruption of a complex industry – something best left for the expert agency at fault to determine and address in the first instance. The right answer would have been, as has been the practice by other courts, to order that the offending agency use its statutory authority and expertise to craft the proper remedy for the interests it has aggrieved.

There is no denying that the FCC has created a mess by its unlawful actions. But not requiring it to provide a remedy because of the complications that its actions have created establishes a dangerous precedent wherein agencies will try to insulate their unlawfulness by taking actions that are simply too big to remediate. It is the creation of this hazard that merits review of this case.

The Third Circuit's discussion of remedies fails to recognize that unlawful agency action harms not only particular parties, like Petitioners, but more importantly the public interest in general. *See Council Tree Comm'ns,* 619 F.3d 235, 257-8. The FCC's actions likely created unjustified windfalls for the winning licensees by effectively eliminating a statutorily based category of competition for the spectrum. In the context of this great harm to the public interest, the brief examines two possible remedies and how the FCC can effectuate them in ways that are balanced and equitable to the parties involved.

ARGUMENT

I. A Judicial Mandate Is Necessary to Ensure the FCC Rights Its Wrongful Act

This Court has held that an agency can rescind its previous action in order to give effect to the judicial decision invalidating its previous order and that administrative agencies have broad discretion in fashioning remedies especially when an agency is giving effect to a judicial decision. *See United Gas Improvement Co. v. Callery Properties, Inc.*, 382 U.S. 223, 227 (1965). Lower courts have also supported an expansive view of agencies' power to provide remedies. In *Natural Gas Clearinghouse v. FERC,* 965 F.2d 1066 (D.C. Cir. 1992), the D.C. Circuit stated that "[a]n agency, like a court, can undo what is wrongfully done by virtue of its order" and that in the absence of such broad "corrective power, . . . judicial protection might be a virtual nullity." 965 F.2d at 1074-75.

The FCC itself has also previously acknowledged the breadth of its own discretion to fashion novel and unique remedies. *See QUALCOMM, Inc.* 16 F.C.C.R 4042 (2000). The FCC's ability to fashion an appropriate remedy is derived from two separate parts of Section 4 of the Communications Act of 1996, 47 U.S.C. §§ 151 et seq. ("Communications Act"). First, Section 4(i) establishes the general, broad authority for the Commission to "perform *any and all acts*, make such rules and regulations, and issue such orders, not inconsistent with this Act, as may be necessary in the execution of its functions." 47 U.S.C. § 154(i)

(emphasis added). The Commission has previously relied on Section 4(i) of the Communications Act to justify the creation of a remedy for which there was no separate, specific statutory authorization as would be the case here. *See New England Tel. & Tel. Co. v. FCC*, 826 F.2d 1101, 1107 (D.C. Cir. 1987) ("We find this wide-ranging source of authority adequately supports the Commission's remedial action"); *see also N. Am. Telecomm. Ass'n v. FCC*, 772 F.2d 1282, 1292 (7th Cir. 1985) (Section 4(i) "empowers the Commission to deal with the unforeseen – even if that means straying a little way beyond the apparent boundaries of the Act – to the extent necessary to effectively regulate those matters already within the boundaries.").

The "not inconsistent with the Act" provision of Section 4(i) therefore operates as a distant limit to the scope of remedies that the FCC can fashion as the Commission carries out its duties under the Communications Act – including its duties under Section 309 at issue in this case. *See New England Tel. & Tel. Co.*, 826 F.2d at 1107. Second, Section 402(h) specifically authorizes the Commission to "carry out the judgment of the court," and thereby compels the FCC to enforce a reviewing court's judgment. 47 U.S.C. § 402.

Despite the FCC having the power to create a wide range of remedies, the agency is compelled to rectify the harm its actions have caused only by a clear mandate from a reviewing court. In *Qualcomm, Inc. v. FCC*, 181 F.3d 1370 (D.C. Cir 1999), the D.C. Circuit was forced to reiterate to the Commission that it was required under the facts of that case to exercise its broad power to fashion a novel and apt remedy that would amount

to "concrete relief." 181 F.3d at 1376-7. In this case, the absence of such clarity from the Third Circuit rewards the Commission for being derelict in its proper implementation of Section 309(j) of the Communications Act.

II. The Likelihood of an Unjust Windfall and the Stifling of Competition Are Harms that Need to Remedied

In choosing not to impose a remedy, the Third Circuit focused on perceived inequity to the entities that won licenses at Auctions 66 and 73. Specifically, the court cited the "massive uncertainty, waste, and frozen development [that] would occur from the time of the rescission until the re-auction." *Council Tree Comm'ns,* 619 F.3d 235, 257. In addition, the Third Circuit agreed with intervening parties that "the state of the economy and the credit markets has changed dramatically since the auction; consequently, participation by some parties might be impractical or impossible" and would be unfair because it would "require these intervenors to pay sums that they may not have in order to protect investments they have already made, and perhaps cannot recoup without the relevant spectrum licenses." *Id.* at 257-8. The Third Circuit also found little reason to disturb current licensees and their investments because "[t]he record gives no indication that these intervenors and amici, or other winners of Auctions 66 and 73, were

anything but innocent third parties in relation to the FCC's improper rulemaking." *Id.* at 257.[3]

The Third Circuit's concern about possible inequities to the current licensees blithely ignores the fact that these licensees won their spectrum in auctions where the FCC's rules unfairly restrained competition. The very essence of the FCC's Designated Entity ("DE") program in question in this case is to encourage new entry and to entice more competition for the spectrum through the use of bidding credits, eligibility restrictions, low reserve prices and other mechanisms. *See* 47 U.S.C. §§309(j)(3)(B), (4)(D); *see also Council Tree Comm'ns,* 619 F.3d at n.30. It is axiomatic that increasing the number of participants in an auction is likely to increase the value of the goods being sold. Moreover, in the case of spectrum, which is the core and very scarce resource needed for entry into the marketplace for wireless services, anti-trust theory holds that the *mere* potential of new entry increases the value of the licenses because incumbent service providers are likely to place a higher value on the spectrum above and beyond their own operational needs in order to foreclose marketplace competition from developing. *See Ex Parte* Submission of the United States Department of Justice, *Economic Issues in Broadband Competition, A National*

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[3] Petitioners note that the Third Circuit's characterization of current licensees as "innocent third parties" is misguided as all auction participants were expressly warned by the FCC about, and therefore assumed, all risk of legal challenges to and consequences of the auctions. *See* Supplemental Brief of Petitioners at 34, *Council Tree Comm'ns v. FCC*, No 08-2036 (3d Cir Aug. 11, 2008)

Broadband Plan for Our Future, GN Docket No. 09-51, 7 (Jan. 4, 2010), *available at* http://www.justice.gov/atr/public/comments/253393.htm.[4] The record in the case before this Court demonstrates that the now vacated rules that were in place for Auctions 66 and 73 reduced the number of DE participants in those auctions.[5] Thus, the absence of properly crafted DE rules resulted in less competition for the spectrum and therefore likely created a substantial windfall to the winning bidders. *See Report and Order, Fifth Report and Order, Fourth Memorandum Opinion*

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[4] The Department of Justice discussed the role of market power in spectrum auctions

> [T]he private value [of spectrum] for incumbents in a given locale includes not only the revenue from use of the spectrum but also any benefits gained by preventing rivals from eroding the incumbents' existing business. The latter might be called the "foreclosure value" as distinct from the "use value." The total private value of spectrum to any given provider is the sum of these two types of value However, the "forclosure value" does not reflect consumer value, to the contrary, it represents the private value of forestalling entry that threatens to inject additional competition into the market.

Ex Parte Submission of the United States Department of Justice, *Economic Issues in Broadband Competition, A National Broadband Plan for Our Future*, GN Docket No. 09-51, 7 (Jan. 4, 2010), *available at* http://www.justice.gov/atr/public/comments/253393.htm.

[5] The record demonstrates that DEs had a significantly reduced role in Auctions 66 and 73 winning only 4% and 2.6% of the licenses in terms of dollar values, respectively, as compared to 70% in prior auctions *Council Tree Comm'ns*, 619 F.3d 235, 248.

and Order, and Order, WT Docket 02-55, 19 F.C.C.R. 14969, para. 75-76 (2004).

The Third Circuit's decision to heavily balance the purported inequities in favor of the previous winners without also recognizing the likelihood of a windfall is central to this review. *Council Tree Comm'ns,* 619 F.3d 235, 257-8. The proper view of remedies in this case should not focus on the challenges that they may pose for the beneficiaries of distorted auctions, but rather on whether they can recover any unjust windfall that was created at the expense of the public interest.

III. Possible Remedies that Address the Harm to the Public Interest

The Third Circuit's opinion makes it abundantly clear that its decision to not mandate a remedy for the Petitioners rests primarily on its understanding of *one* particular remedy. *See Council Tree Comm'ns,* 619 F.3d 235, 257-8. That opinion, however, does not fully examine the latitude that the FCC has under the Communications Act to effectuate other remedies that alternatively might be appropriate for the harm its actions caused. In the court's limited view, the only possible remedy is a re-auction of the spectrum that would attempt to put all the *parties back in exactly the same place they were before the start of the auctions.*

The court should have instead focused on the fact that the Commission has the requisite expertise and authority to develop *novel or unique* remedies to address the likelihood that its actions created an unjustified windfall for the incumbent

licensees and limited spectrum opportunities for small businesses and new entrants.[6] Although the continuum of possible remedies for these harms is unknown, the rest of the brief examines how the agency can use its existing authority to fashion two possible remedies that allow for a balancing of competing interests at stake.

A. A "Topping Off" Re-Auction Would Recapture any Unjust Windfall and Could Be an Appropriate Retrospective Remedy

A carefully and equitably crafted re-auction process could claw back any unjust windfall and directly address the harm caused by the FCC auctions.[7] The Commission can do this by

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[6] The Commission itself believes that the Communications Act does not specifically prohibit it from creating novel remedies in the public interest. *See Qualcomm, Inc. v. FCC*, 181 F.3d 1370, 1376 (D.C. Cir. 1999). In developing remedies warranted by the facts of this case, the FCC can avail itself of a great number of tools including bidding credits, eligibility restrictions in future auctions, or even its power to "avoid mutual exclusivity" for licenses at its disposal. 47 U.S.C. § 309(j)(6)(E).

[7] Not only is a re-auction possible but the Commission has done so regularly in order to address policy failures and procedural errors. In 2000, the FCC successfully re-auctioned spectrum that it reclaimed from Nextwave pursuant to its cancellation of those licenses because of Nextwave's failure to make its installment payments. *See FCC v. Nextwave Pers. Comm'ns*, 537 U.S. 293, 296-99 (2003). In other instances, the FCC has conducted re-auctions whenever it has deemed that the auction rules that it promulgated failed to achieve its purposes. In 2002, the FCC auctioned the Lower 700 MHz spectrum using reserve prices that failed to achieve winning bids for a number of

conducting a limited "topping off" auction wherein DEs and the previous winning bidders would be afforded a chance to bid above and beyond the previous auction value of the spectrum licenses. In this particular process, the reserve prices for the re-auctioned spectrum would be set at the price paid for the spectrum in the previous auction plus any direct costs incurred by the previous winners for maintaining the spectrum's viability in the interim. Each incumbent licensee would be provided with bidding credits equal to the reserve price. To directly address the harm caused to DEs by the unlawful agency action and to prevent the likelihood of competitive gamesmanship among market participants, the FCC would promulgate eligibility requirements restricting the bidding for any particular license to DEs and the current licensee. Such a safeguard would ensure that the remedial auction would only provide the opportunity to DEs who were excluded by the Commission's unlawful actions.

To the extent that the reserve price for a particular license is not met, the current licensee

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licenses. *See Revised Inventory and Auction Start Date For Auction of Lower 700 MHz Band Licenses; Comment Sought on Reserve Prices or Minimum Opening Bids and Other Auction Procedures*, 68 Fed. Reg. 6452 (Feb. 7, 2003). The FCC re-auctioned these licenses by changing the auction rules and was able to find a clearing price for all the licenses. Similarly, in 2005 the FCC re-auctioned PCS spectrum left over from the 1994 and 1996 auctions that failed to achieve clearing prices. *See Auction for Broadband PCS Spectrum Scheduled for May 16, 2007; Comment Sought on Competitive Bidding Procedures for Auction No. 71*, 71 Fed. Reg. 69125 (Nov. 29, 2006).

would keep its license; should bids be higher than the reserve, winning bidders would be issued their license when they have paid the existing licensee the reserve price and the United States Treasury the net between the reserve and the winning bid amount. As was the case in all of its previous auctions, the FCC would also establish a deadline for the transfer of the spectrum and encourage the new and previous licensees to enter into private negotiations and contracts to facilitate an earlier transition on their own accord and based on their respective circumstances. *See Ass'n Pub. Safety Comm'ns Officials-Int'l v. FCC*, 76 F.3d 395 (D.C. Cir 1996).

This type of re-auction is similar to and contains key elements of past FCC auctions which have reallocated spectrum between parties and between different uses. Because the auction is designed only to test whether there would be any "topping-off" bids for each license, it would address the problem that the licenses might have been sold at less than market value because the FCC unlawfully limited competition.[8]

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[8] The FCC has previously used its statutory authority to craft an anti-windfall mechanism designed to capture, in the public interest, the windfall that might result from its spectrum allocation process. *See Report and Order, Fifth Report and Order, Fourth Memorandum Opinion and Order, and Order*, WT Docket 02-55, 19 F.C.C.R. 14969, para. 75-76 (2004).

B. Use of Auction Discount Vouchers Would Encourage Competition for Spectrum and Could Be an Appropriate Prospective Remedy

If, as the FCC contends, it is not practical to look backwards, an alternative remedy would be to look forward and ensure that small businesses are guaranteed meaningful access to future spectrum auctions. The FCC's use of Auction Discount Vouchers ("ADVs"), which are bidding credits that can be redeemed at future auctions, is a precedent for this approach. Although a forward looking remedy such as an ADV does not address the fundamental inequities of the FCC's actions in Auctions 66 and 73, it is a tool that the FCC has relied on in the past. In 2002, in an analogous case, the FCC resolved litigation with Qualcomm by granting Qualcomm a transferable ADV in the amount of over $125 million that had to be used in any spectrum auction over a three year period. *See QUALCOMM, Inc.*, 16 F.C.C.R. 4042 (2000).[9] As in the instant case, the FCC's use of ADVs allowed the agency to fulfill its statutory obligation to encourage new competition for spectrum while providing an equitable remedy to the aggrieved petitioner without necessarily affecting the

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[9] Qualcomm was able to use its ADVs to aggregate licenses from various auctions to create a new class of wireless services underscoring the value of the ADVs. *See* Qualcomm, Inc., Press Release, *Qualcomm Subsidiary to Support Nationwide Delivery of Mobile Multimedia in 700 MHz Spectrum* (Nov. 1, 2004), *available at* http://www.qualcomm.es/news/releases/2004/041101_mediaflo_700mhz_print.html.

immediate rights of the parties that obtained licenses in the interim. *Id.*

In the instant case, the use of ADVs may prove to be the most practical remedy since the FCC has recently indicated that large amounts of spectrum will be auctioned over the next decade. In order to meet growing demand for wireless broadband services the FCC and the Obama Administration have called for 500 megahertz of spectrum to be made available for mobile, fixed and unlicensed broadband use over the next 10 years. *See* Federal Communications Commission, *Connecting America: The National Broadband Plan* (Mar. 16, 2010), *available at* http://download.broadband.gov/plan/national-broadband-plan.pdf; *see also* Presidential Memorandum on Unleashing the Wireless Broadband Revolution, 75 Fed. Reg. 38387 (July 1, 2010).

CONCLUSION

The Third Circuit's failure to order the FCC to provide a remedy for its unlawful actions creates a dangerous and morally hazardous legal precedent whereby agencies are indemnified from the cost of their unlawful actions by doing things that are simply too big to undo. Remedial actions to be taken by the FCC for recalibrating the opportunity cost of the spectrum that was unlawfully auctioned in Auctions 66 and 73 including those outlined in this brief will be complicated by the passage of time, the number of licenses issued, and the sums of monies involved. Those complications in no way lessen the imperative for the Third Circuit to have mandated an effective remedy. For the foregoing

reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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v.

FEDERAL COMMUNICATIONS COMMISSION AND THE UNITED STATES OF AMERICA,
Respondents.

On Petition for a Writ of Certiorari
To the United States Court of Appeals
For the Third Circuit

BRIEF OF PROFESSOR DANIEL B. RODRIGUEZ AS *AMICUS CURIAE* ON BEHALF OF PETITIONERS

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QUESTION PRESENTED

Section 706 of the Administrative Procedure Act, 5 U.S.C. § 706, provides that a reviewing court "*shall*— (1) compel agency action unlawfully withheld or unreasonably delayed; and (2) hold unlawful and set aside agency action . . . found to be . . . not in accordance with law . . . [or] without observance of procedure required by law" (emphasis added). In this case, the United States Court of Appeals for the Third Circuit held that the Federal Communications Commission conducted two licensing auctions for electromagnetic spectrum pursuant to seriously deficient, unlawfully promulgated rules. Those new rules effectively precluded significant participation by small businesses in the spectrum licensing auctions, contrary to 47 U.S.C. §§ 309(j)(3)(B) and (4)(D), which require the Commission to design its auctions so as to promote the participation of small businesses therein and to avoid the excessive concentration of licenses. Despite the APA's mandatory language, the Third Circuit concluded that it had discretion to decline to set aside the results of the licensing auctions, or order any other remedy for petitioners' effective exclusion from the auctions, in conflict with the decisions of other circuits. The question presented is:

Whether a reviewing court has the discretion under Section 706 of the APA to decline to set aside, or provide any remedy for, unlawful agency action?

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INTEREST OF THE AMICUS[1]

Professor Daniel B. Rodriguez is a distinguished teacher and scholar of administrative law who has authored an important article on the specific topic of remand without vacatur, the basic practice in dispute in this case and the subject of the petition before this Court. *See* Daniel B. Rodriguez, *"Of Gift Horses and Great Expectations: Remands without Vacatur in Administrative Law,"* 36 Ariz. St. L.J. 599 (2004).

Professor Rodriguez submits this brief in support of petitioners' request for certiorari but without any opinion about, or expertise in, the underlying Federal Communications Commission proceeding involved in this case. His interest is limited to issues concerning remedies and judicial practice under general principles of federal administrative law.

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[1] Pursuant to Supreme Court Rule 37.2(a), amicus represents that counsel of record for all parties received timely notice of the intent to file this brief and all parties have provided written consent. A letter from the Petitioners reflecting their global consent to the filing of amicus curiae briefs is on file with the Clerk of the Court. No counsel for any party has authored this brief in whole or in part, nor has any person or entity, other than amicus and his counsel, made a monetary contribution to the preparation or submission of this brief.

SUMMARY OF THE ARGUMENT

Amicus respectfully urges this Court to grant certiorari in this case in order to resolve a hotly disputed issue in administrative law that is, the question whether and in what circumstances a reviewing court should grant remand without vacatur when the court finds unlawful an administrative agency action. Certiorari is warranted for the following reasons: First, remand without vacatur, a practice of fairly recent origin, is in tension with the language and structure of the Administrative Procedure Act ("APA"); second, the standards the D.C. Circuit and other appellate courts use to decide whether the remand without vacatur device is warranted in a particular case are ill-defined and hard to apply; third, this rudderless discretion threatens important administrative values by creating unfortunate incentives in agencies and relying on courts to make speculative judgments without adequate information; and, finally, this Court can usefully settle a matter of national importance to the process of administrative law by articulating – of the Court declares this practice to be legally permissible – sensible guidelines for the exercise of judicial discretion.

ARGUMENT

I. Remand without vacatur is in tension with the language and structure of the Administrative Procedure Act

Although the APA can be, and certainly has been, criticized as ambiguous in key respects, the text relevant to this dispute over remand without vacatur is a model of clarity. Section 706 provides that a reviewing court "shall . . . set aside [unlawful] agency action." 5 U.S.C. § 706. Be that as it may, reviewing courts – most conspicuously, the D.C. Circuit – have read "shall" out of the statute, arguing in essence that the APA does not disturb the historic power of the federal courts to fashion remedies which suit practical considerations in the complex administrative state of the modern era. See, e.g., *Comcast Corp. v. FCC*, 579 F.3d 1 (2009) *and sources cited therein*. This proposition is in tension with the basic apparatus of administrative remedies embodied in the APA. The APA, *inter alia*, provides the structure in which reviewing courts carry out their responsibilities and exercise their discretion. That some discretion remains notwithstanding the enactment of the APA is clearly correct. However, the general policies underlying the APA and modern administrative law do not provide support for the idea that the APA left undisturbed the pattern of equitable judicial remedies and thus is primarily hortatory rather than mandatory. *See, e.g.*, *Darby v. Cisneros*, 509 U.S. 137 (1993); *Bowen v. Georgetown Hospital*, 488 U.S. 204 (1988); *NLRB v. Food Store Employees Union, Local 347*, 417 U.S. 1 (1974); *Federal Power Comm'n v. Idaho Power Co.*, 344 U.S.

17 (1952). See also Antonin Scalia, "Vermont Yankee: The APA, the D.C. Circuit, and the Supreme Court," 1978 Sup. Ct. Rev. 347.

This Court's decision in *Hecht Co. v. Bowles*, 321 U.S. 321 (1944) is not to the contrary. In that case, this Court declined to read the relevant statute to displace district court's traditional equity power to issue or decline to issue injunctions. The decision did not suppose that APA guidelines are subordinate to equity power, but only that Congress must act to displace such power "unequivocal[ly]." 321 U.S. at 329-30. As one judge put it in a recent concurring opinion involving remand without vacatur: "[T]he *Hecht* canon – if it is that – does not preserve a court's remedial discretion . . . if Congress has limited the discretion in clear terms." *Comcast*, 579 F.3d at 12 n.1 (Randolph, J., concurring).

Judicial remedies in administrative law should be understood against the backdrop of the larger administrative law system, a system which is structured since 1946 around the APA's guidelines, along with statutory rules embodied in other pertinent regulatory legislation. While, to be sure, "pragmatism and flexibility have been recurrent and durable themes in the jurisprudence of administrative law remedies,"[2] such pragmatism can best be understood in connection with the responsibilities of reviewing courts to give force to their judgments about the legality of administrative

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[2]Ronald M. Levin, 'Vacation' at Sea: Judicial Remedies and Equitable Discretion in Administrative Law, 53 Duke L.J. 291, 345 (2003).

rules. For example, a court may look at a problematic rule as revealing a plausible policy choice by an agency and thus within the scope of agency discretion. In doing so, the court is acting with appropriate humility – that is, it is acting pragmatically. Or a court may find a statute as so open-ended as to leave the court with "no law to apply," thereby concluding that the agency decision is "committed to agency discretion by law." *Citizens to Preserve Overton Park v. Volpe*, 401 U.S. 402, 410 (1971). Pragmatism and flexibility are sensible lodestars in these contexts. Indeed, the basic prerogative of remand indicates that a pragmatic, rather than a more mechanical, approach, may be warranted in a given case. But just as the agency lacks the power to simply decline to follow a clear rule of administrative procedure because it would be hugely inconvenient or expensive to do so, the reviewing court equally lacks the power to pick and choose among the obligatory rules of the APA in an effort to preserve flexibility and discretion.

II. Even if the remand without vacatur device is a legally permissible option, the standards the courts use to exercise their discretion are ill-defined and hard to apply

The D.C. Circuit, the court most prominent in the development and implementation of the remand without vacatur device, has indicated that the decision to order a remand without vacatur would depend on "the seriousness of the order's deficiencies (and thus the extent of doubt whether the agency chose correctly) and the disruptive consequences of

an interim change that may itself be changed." *International Union, UMW v. FMSHA*, 920 F.2d 960, 967 (D.C. Cir. 1990); *Accord Allied-Signal, Inc. v. U.S. Nuclear Regulatory Comm'n.*, 988 F.2d 146 (D.C. Cir. 1993). These standards are opaque and incorrigible. Requiring the court to make a judgment about how confident they were in their holding that the agency violated the law is an unusual request; and although focusing on the consequences of the change jibes with analogous situations of judicial discretion in the remedial context, the nexus between consequences and the risk that the interim change "may itself be changed" poses a different matter. The reviewing court will typically lack the information that is centrally relevant to his determination, that is, the likelihood that the agency will take another stab at creating a rule and, thereafter, the likelihood that a panel of the circuit court will or will not find that substitute rule (and rationale) wanting.

To see how some of these difficulties might emerge, consider the different contexts in which agency decisions post-remand will come to reviewing courts: First, and perhaps most commonly, there is the situation in which the agency must come up with a different rationale for essentially the same rule. *See, e.g., Milk Train, Inc. v. Veneman*, 310 F.3d 747 (D.C. Cir. 2002). Predicting whether the agency will be able to furnish a suitable rationale is a difficult enterprise at best, and it surely goes beyond what this Court has determined to be the proper role of the reviewing court. *See SEC v. Chenery*, 318 U.S. 80, 87-89 (1943) (holding that reviewing courts should not uphold an agency decision on a basis other than the one advanced by the agency). Second, there are

situations in which the rationale for the agency action is unclear. *See Checkosky v. SEC*, 23 F.3d 452 (D.C. Cir. 1994). While remand without vacatur in order to yield a clearer basis for evaluating the agency's reasoning seems most defensible in this circumstance, this Court has not warranted this practice and, indeed, the circuit courts' adoption of the practice is of fairly recent origin.[3] Third, and finally, situations arise in which the agency's rationale is straightforward and, although it cannot be squared with the law, the court invokes "obvious hardship" to justify a no-vacatur order. *See, e.g., American Medical Ass'n v. Reno*, 57 F.3d 1129 (D.C. Cir. 1995). This is the reasoning behind the Third Circuit's remand without vacatur decision in this case. In this third category of cases, the problem is not a lack of information, but a patent unwillingness to upset the apple cart. That these three scenarios involve profoundly different situations and thus implicate very different rationales and policy matters reveals why this broad judicial discretion is best characterized as rudderless.

The problem of incoherent standards is especially acute in the context of administrative law. Here the standard for determining whether remand without vacatur is appropriate requires not only an assessment by the reviewing court about the costs and benefits of the rule's invalidation, but also, critically, on speculations about what an agency may

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[3] See Levin, *Remand*, supra n 1 at 298 ("Until recently, reviewing courts routinely vacated agency actions that they found to have been rendered unlawfully That practice was generally accepted and essentially taken for granted")

or may not do after the remand order. The basic puzzle, then, is that a court is supposed to make a judgment about whether or not to vacate the rule without knowing what the agency will do and how they will do it. Judge Randolph, who has frequently dissented from his court's remand without vacatur practice, puts his finger on the essential dilemma: "[R]emand-only decisions are being made without sufficient information, which is one of the main reasons the cases are so difficult to reconcile." *NRDC v. EPA*, 489 F.3d 1250, 1263 (Randolph, J., concurring). *See also Comcast*, 579 F.3d at 11 (Randolph, J., concurring); *Checkosky*, 23 F.3d at 491 (Randolph, J., dissenting in part).

III. This rudderless discretion threatens important administrative law values

The uncertainty embedded in the remand without vacatur doctrine presents perils for both administrative agencies and reviewing courts. With respect to agencies, key decisionmakers may make the unfortunate calculation that adopting an administrative rule that is ill-reasoned and ultimately unsupportable under the APA or the relevant organic act is worth the price of invalidation, given that no direct consequence, other than a remand, follows from a court's order. Without making any extravagant claim that such calculations are frequent, that administrative decisionmakers have the opportunity which remand without vacatur makes possible to game the system is for that reason alone a risk not worth running. The consequences for

sound administration are certainly problematic and perhaps worse than that.

This practice disrupts the work of reviewing courts as well. Without clear standards for sorting out when remand without vacatur is warranted and when it is not, courts will exercise their discretion in unpredictable, if not random, ways. One temptation, illustrated well by this case, is to look at the economic impact of their judgment and to conclude that some agency actions are "too big to fail." By hypothesis, rules which matter greatly to the well-being of particular persons impacted by them but are not of widespread economic consequence will therefore fall more easily under the category of "discretion" and will more commonly be subject to remand without vacatur. To be fair, this depiction, as with the claim made about agency incentives above, is theoretical and speculative. But supposing that agencies and reviewing courts act consistently with not only the doctrinal rules and standards announced by this Court and other federal courts but also with the structure of incentives generated by doctrine, we should be wary of the unintended consequences of a judicial practice which is so flexible as to be unmoored in transparent, articulable, and predictable guidelines.[4]

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[4] An additional consideration, noted here but not explored in depth, is the salutary incentives that vacating agency rules would perhaps have for Congress to address these issues with clearer legislation. As one commentator shrewdly notes, "vacatur also advances the original structure of constitutional lawmaking by giving Congress incentives to replace defective agency rules with specific legislation." Boris Bershteyn, Note,

This rudderless discretion is of particular concern in the context of administrative law. Regulatory agencies wield immense public power. The consequences of both good and bad rules can be enormous. That these agencies act in the lacuna of formal constitutional structure, that is, they are not part of any of the three named institutions of the federal government but are, as famously noted, a "headless fourth branch of government," raises special concerns for American democracy and constitutional governance. Our system of law works hard to assuage these concerns by creating sensible checks on administrative power. The function of these checks is undermined where the rules of hard to identify and to follow. Although it is always tempting to valorize pragmatism and flexibility in judicial review of agency action, especially when it pertains to the crafting and implementation of remedies, this Court has made clear in its administrative law jurisprudence that both agencies and reviewing courts should be guided by clear, transparent, and reliably enforced legal rules. *See, e.g., Georgetown Hospital*, 488 U.S. 204, 208 (1988) (declined to find agency discretion to engage in retroactive rulemaking "unless that power is conveyed by Congress in express terms); *see also id.* at 216-25 (Scalia, J., concurring) (acceptance of agency's position would "make a mockery . . . of the APA") (quoting from court below at 821 F.2d at 758).[5]

An Article I, Section 7 Perspective on Administrative Law Remedies, 114 Yale L.J. 359, 391 (2004).

[5] It is telling that the remand without vacatur devise arose soon after this Court's *Georgetown Hospital* decision. Indeed, Professor Richard Pierce has noted, remand without vacatur

IV. This Court should consider this case to determine whether remand without vacatur is legally permissible and, if concluding that the practice is permissible, clarify the circumstances under which reviewing courts should exercise their discretion to employ or not to employ the practice

Neither this case nor, frankly, any other case will provide an ideal vehicle for this Court to decide and explain once-and-for-all what it means for reviewing courts to have meaningful remedial discretion. However, this Court should take the opportunity presented by this case to establish a clearer set of guidelines for determining when remand without vacatur is and is not appropriate. At the very least, these guidelines should be shaped by considerations that (1) can be reconciled at both the specific and general level with the APA's procedural structure and purpose, (2) involve considerations that a reviewing court can evaluate without resort to predictions about future agency behavior, and (3) do not create unfortunate incentives for administrative agencies to game the system after remand. While not presuming

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"was motivated largely by a desire to avoid the potential disruptive effects" of *Georgetown Hospital*. Richard J Pierce, Jr., *"Seven Ways to Deossify Agency Rulemaking,"* 47 Admin. L. Rev. 59, 75-76 (1995). Perhaps so. But one need not attribute particular motives to judges on the D.C. Circuit or elsewhere to reach the conclusion that administrative law remedies must track the requirements of the APA – not only as a matter of judicial fidelity to statutory requirements, but because of the sound policy reasons for tethering both administrative and judicial discretion to the rule of law in regulatory administration.

here to fashion a set of coherent guidelines for this purpose, this Court would greatly assist the development of administrative law remedies by taking the opportunity to clarify whether and when remedial discretion is appropriate in the context of judicial review of agency rulemaking.

CONCLUSION

For the foregoing reasons, as well as those set for in the petition, this *amicus curiae* urges this Court to grant the petition for a writ of certiorari.

Respectfully submitted,

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